



Local Government
and Public Service
Reform Initiative

FROM USAGE TO OWNERSHIP

Transfer of Public Property to Local Governments in Central Europe

Edited by GÁBOR PÉTERI



IGI Studies



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Serbia Local Government
Reform Program
Program za reformu
lokalne samouprave
u Srbiji

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Foreword

Decentralization and the establishment of a modern public sector raise the need for transforming monopolistic state ownership. In transition countries the transfer of state property to new owners has been implemented through restitution, privatization and property devolution. The combined affects of these processes created various models with different scales and types of local government property.

Since the early years of transition, property devolution has been a highly debated issue in Central and Southern Europe. This publication aims to summarize the experiences of four Central European countries. The experiences of Hungary, Latvia, Poland and Slovakia might provide lessons for countries which started the property devolution process later.

The specific reason for collecting information on these four countries was to support the local government reform process in Serbia. The Serbia Local Government Reform Program (SLGRP) has documented that the most important obstacle, by far, for the reform of the system of local self-government in Serbia, as perceived by local government officials, was state ownership of the all property used by cities and municipalities. To address that problem SLGRP, the Local Government Initiative of OSI–Budapest, the Standing Conference of Towns and Municipalities and the PALGO Center designed the Property Devolution to Local Governments in Serbia project.

The Serbia Local Government Reform Program, funded by United States Agency for International Development and implemented by Development Alternatives Inc., in cooperation with the Open Society Institute, the PALGO Center, the Development Alternatives Inc., Mendez England and Associates, the Foundation in Support of Local Democracy, the International Cooperation Agency of the Association of Netherlands Municipalities, IGE Consulting Limited, the Center for Community Organizing, Rutgers

University and the European Movement in Serbia, is designed to revitalize the deep roots of strong community-based management forms within Serbian society in order to reestablish an effective, responsive and accountable local government tradition.

The Local Government and Public Service Reform Initiative (LGI), a regional program of the Open Society Institute–Budapest, aims to support information exchange between countries in the region. LGI's mission is to facilitate the knowledge transfer between Central and Eastern European countries, which share common traditions and history. Public sector reform is the focus of LGI's projects, and we believe that this publication on property devolution will provide useful information for other countries, as well.

The program in Serbia had other activities beyond providing four case studies of property devolution processes in the CEE countries. Local and international specialists conducted analyses of the Serbian legal framework for property devolution, organized presentations on these findings to the policy community in Serbia and prepared policy recommendations for property devolution. The next step will be the organization of a National Conference on Property Devolution to help place this question on the agenda of the government and parliament of the Republic of Serbia. The SLGRP will finally help a working group finalize a Draft Law on Property Devolution.

We hope that this publication on property devolution will further support the decentralization process in Serbia and provide useful information for policy-makers working on public sector reform in other countries of the region.

Belgrade–Budapest, March 2003

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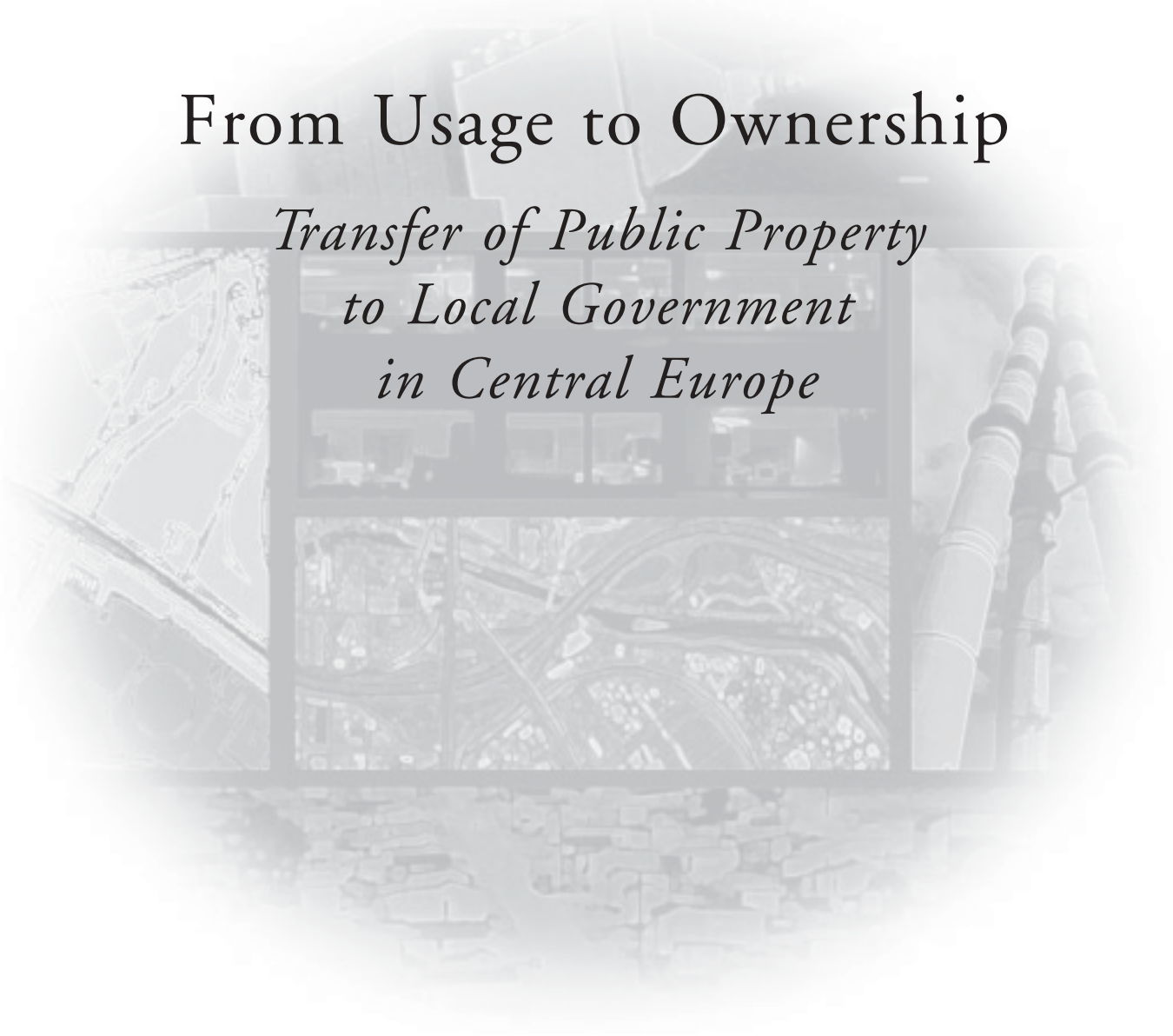
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Gábor Péteri

From Usage to Ownership

*Transfer of Public Property
to Local Government
in Central Europe*



From Usage to Ownership

Transfer of Public Property to Local Governments in Central Europe

Gábor Péteri

1. INTRODUCTION

Decentralization reforms have to do with problems of ownership. Property is one of the basic pre-conditions for autonomous local government. In transition countries, property devolution was implemented together with the dismantling of 'social ownership.' The countries of Central Europe, for which decentralization was the first step in transition, have accumulated significant experience. Their successes and failures provide lessons for other countries struggling with ownership problems today and in the future.

This report contains summaries of the property devolution process in four Central European countries—Hungary, Latvia, Poland and Slovakia. Information was also collected at a regional workshop in Belgrade, where property devolution practices were discussed with Serbian policy-makers.

These activities were organized within the framework of a cooperation agreement between the OSI-Budapest Local Government and Public Service Initiative (LGI) and the USAID-funded Serbian Local Government Reform Program, managed by DAI Inc. The primary objective of this joint project was to formulate recommendations for Serbia. It is supported by information exchange among professionals. Policies on property devolution for Serbia are continuously being discussed with local counterparts, so the policy proposal included in this publication is still preliminary.

We believe that the experiences summarized in this publication will be useful for other countries. There are several countries in Southeastern Europe, and several others further east, that will have to prepare property devolution policies in the near future. Decentralization and public sector reforms always involve property devolution, so lessons and an inventory of relevant issues should help policy-makers prepare for changes in ownership structures.

The primary concern of this publication is the devolution of public property. The problems of restitution and privatization are discussed elsewhere. Despite the fact that these issues are closely connected to local government property transfer, they are beyond the scope of our work. We still

believe that policy-makers and advisors working on property devolution reform policies will find useful and relevant information in the papers that follow.

2. DEVOLUTION OF PUBLIC PROPERTY IN CENTRAL EUROPE

2.1 Arguments for and against Property Devolution

Professional and political debates on public sector reform in transition countries revolved around three interrelated issues: (i) political decentralization, (ii) re-assignment of public functions and their funding and (iii) transfer of state-owned assets. Multi-party systems, free elections and the strengthening of locally-elected bodies form the basis of modern local governments. Increased local political autonomy was combined with transfer of municipal services and new intergovernmental financial relations. As part of the fiscal decentralization process, the status and size of municipal property was also settled. During this reform process, property devolution was discussed extensively in all transition countries, leading to the elaboration of several arguments for and against public property devolution.

2.1.1 *Why Decentralize?*

The most evident argument for property devolution was *political*: there can be no real local government without a sound economic basis. Generations of politicians were raised on Marxist theory, so it was easily understood that ownership was the fundamental condition for systemic regime change. An *economic* rationale, based on public choice theory, also argued for decentralization of state-owned assets. According to this argument, effectiveness and efficiency in public service delivery can only be achieved if decisions are made at

the level of government which is responsible for funding and control of the service.

Significant own sources are required for *fiscal* decentralization, and local government property can be an important source of municipal revenues. The sale of local assets creates one-time capital revenues, and local property can also contribute to current budgets through operating revenues collected as fees, rent, dividends, etc. Local property as collateral for municipal borrowing indirectly supports local capital investments. *Financial* arguments also include the claim that municipal property is the basis for local economic development through public-private partnership schemes.

2.1.2 Counter Arguments

Despite strong reasons for property devolution in Central and Eastern Europe, *arguments against* property transfer were also articulated. In the preparatory stage and the first period of transition, decentralization of public assets was often regarded as a *loss of national property*. However, decentralization does not necessarily mean a loss of public assets. It only changes the proportion of assets owned by the various levels of government. Rules and methods for property management can prevent economically unsound decisions.

From the point of view of local government finance, a common counterargument claimed that property transfer *increases imbalances* among municipalities. Rich urban municipalities become owners of valuable assets, while poor rural local governments are not able to benefit from public property transfer. This argument fails to consider the differences in public service delivery (cities manage more services than rural communities) and other components of intergovernmental fiscal relations (vertical and horizontal equalization schemes).

Perhaps the most frequent argument against property devolution was the claim that it will lead to *inefficient property management*. The lessons from the era of command economics with large state-owned enterprises and centrally-controlled allocation decisions proved the opposite. Despite the relative inexperience of the new administrations, local governments were consistently able to develop more efficient methods of property management. Transparency of local decisions prevented the misuse of public assets, which was not the case during the centrally-managed privatization process.

2.2 What Should be Transferred?

Once a political consensus for devolution had been reached, several technical questions were raised: What should be the

basis of property transfer? How much time should be allowed for implementation? Are local governments allowed to accept the transfer of deteriorated public assets? Can municipalities act as entrepreneurs? Responses to these questions varied from country to country.

As a first step, the *scope of public property* had to be defined in some countries. In Latvia, where independence had been lost to Soviet rule, public assets first had to be ‘nationalized’—transferred to the new Latvian state. In Hungary, the categories of state and local/municipal property had to be legislated as well. This was followed later by privatization and the decentralization of public assets.

2.2.1 Functional Approach

The basic principle behind property devolution is functional: all assets connected to functions assigned to local government should be transferred to those governments. Some legislation identified groups of assets that must remain under state control (natural resources, waters, important roads, airports, telecommunications frequencies, etc.).

Beyond these restrictions, when a certain level of government (village, city, county, etc.) took responsibility for a specific service (education, utilities, etc.), then all the assets required for the delivery of that service had to be transferred to that level of government. As the assignment of local government functions was implemented over a significant period of time, public assets could be transferred in several stages.

For example, the establishment of regional government in Slovakia and Poland was accompanied by the reallocation of public assets: regional governments became owners of service organizations, assigned to these newly-created tiers of government. Property devolution might be implemented at *different speeds* according to the rules of decentralization in specific service areas (e.g., in Poland, public education was an optional local service for several years, so the mandatory transfer of schools was enacted only in 1996). In Hungary, legislation was enacted in two stages: first the general boundaries of local government property were legislated by constitutional law; later, it was followed by a specific law on actual forms and ways of property transfer.

As soon as local governments became proprietors, former owners had no right to claim *compensation*. This legal declaration was needed to ensure that local governments were the real owners of the assigned property. Clear regulations had to exclude any further restitution claims. Had the ownership of municipal assets been debated for a long time, municipalities could not have become real actors in the privatization process.

2.2.2 *Timing*

Two basic procedural issues commonly arose during property devolution: the time-scale for implementation and the option to refuse a transfer. In the case of budgetary service organizations, property had to be transferred simultaneously with the transfer of functions. However, state enterprises in the manufacturing and public utility sectors could be transferred gradually, piece by piece. For such assets, a deadline for completion was usually set.

Another timing issue was based on the operational forms of local entities. In Hungary, local governments had to specify the organizational setting of local utilities before 1996. They were presented with three options: (i) to manage the service from within the local administration, (ii) to establish a budgetary organization or (iii) to establish an entity according to the Enterprise Law. This forced municipalities to avoid unclear forms of 'public companies' and develop more efficient and acceptable forms of operation.

An important decision on property transfer was the selection of a *reference date*, when the status of public assets was defined. This technical question had a political background—it should have been fixed at the moment when the communist takeover began. In Latvia it was quite easily identifiable as the date the Republic of Latvia became part of the Soviet Union (July 21, 1940). In Hungary (1948) and Slovakia (1949) the dates were set to indicate the moment when the multi-party political system was terminated. These reference dates impacted all forms of property transfer, such as privatization, restitution and the transfer of church property.

2.2.3 *Obligation to Accept Ownership*

Whether or not property transfer would be voluntary was similarly addressed. It was obligatory for local governments to accept property that had been transferred to localities as part of the decentralization process. When a particular function was localized, the accompanying property was also transferred, including all liabilities. Local governments had no right to 'cream off' the most lucrative properties to avoid the financial burden of deteriorated assets with a negative value (e.g., social housing in large cities).

However, there were some instances when local governments still had the right to refuse ownership of public property. In Latvia, particular units of state property under ministerial control could be rejected by localities. In Slovakia, local governments had the authority to reject liabilities exceeding the value of the property and specified types of liabilities (unpaid taxes, social charges, etc.).

In Hungary, state-owned assets that had not been previously managed by local governments or those with significant protection costs (historical monuments, natural reserves) could also remain at the national level. In the case of transferred social housing and public utility companies, local governments were obliged to own the transferred property. However, individual municipalities had the right not to accept shares in utility companies if assets were distributed between several local governments. These assets were not transferred back to the state; other municipalities simply received more shares.

2.2.4 *Local Businesses*

The property transfer and decentralization process was combined with a debate on the entrepreneurial and business functions of local governments. Under the soviet system, municipalities and counties had a strong influence on state-owned enterprises through political channels. There were relatively high hopes among several reformers that, under market conditions, local governments might directly benefit from the ownership of these public entities.

'Entrepreneurial local governments' were regarded as significant sources of revenues for public budgets. The first generation of mayors was rather active in investing local government assets. According to this strategy, local governments received shares in formerly state-owned companies and then had the right to acquire land and benefit from privatization revenues. Legislation in some countries (e.g., Latvia) clearly stated, that municipalities could conduct any type of business; in others, specific rules of entrepreneurial property transfer were established (in Hungary, former state-owned urban lands without any structures became local assets; municipalities could benefit from privatization up to the land-value of companies).

Involving local governments in business risks may endanger the delivery of public functions. Experience from the business sector also proved that only every fifth new business survives long-term and that municipalities are not prepared to manage such activities. For example, legislation on municipal business activities in Hungary allows only participation in companies with limited liability.

2.3 *Subjects of Property Devolution*

Within the framework of these general rules, legislation on property transfer usually specifies the subjects of devolution in great detail. Property transfer is based on the *location* principle, so previous state-management responsibilities are not

considered (except in Latvia, where management was the primary condition for decentralization). Characteristics of selected major groups of local government assets will be discussed below.

2.3.1 *Waters and Natural Resources*

Natural waters are usually transferred to local governments, assuming that these waters have a minor significance and that they lie within the boundaries of the municipality. Larger rivers and lakes are deemed national or public (in Latvia) property. Waters under the earth's surface are regarded as natural resources, so only its usage (not its ownership) is regulated. Charges on water use and leasing fees can be shared with local governments in some countries (leasing revenues for fishing rights in Latvia; excavation charges shared with local governments in Poland). On the other hand, local governments tended to have the right—and obligation—to manage riverbanks, lakeshores, flood protection facilities and equipment.

2.3.2 *Land, Public Spaces*

Local governments became owners of public spaces, such as streets, squares and city parks within their territory. Usage of these assets was limited, and their value was hardly assessable. Local governments had very limited autonomy in modifying the purposes of use. They had a larger stake in the transfer of urban and agricultural land. In Slovakia, land and forests owned by municipalities before the reference date were transferred to local governments. In Hungary, local governments received undeveloped state-owned plots. In agricultural regions, local governments had to apply for land (to the State Land Service in Latvia, to the National Land Fund in Poland) allocated to various owners during land reform.

2.3.3 *Service Organizations, Urban Infrastructure*

As in most cases, ownership of service organizations followed the transfer of competencies and functions. Local governments became the owners of real estate, equipment and intangible assets belonging to schools, cultural centers, sports organizations and social or healthcare institutions. The rights to use these assets were limited both by sectoral (professional) guidelines and general provisions on property management. The former included, for example, regulations on the closing of schools; the latter included restrictions on the use of property as collateral, requiring permission for changes to buildings with historical value, etc.

Transfer of urban and public utility services was restricted in most of the countries studied. Infrastructure networks were under stricter control, so owner municipalities had limited rights to use and alienate these assets. Operational assets, equipment and office buildings could be physically assigned to specific local governments, and they could be transferred to the balance sheet of utility companies.

The privatization of energy and natural gas companies created larger problems for local governments. They could hardly benefit from privatization revenues, because the operating companies were usually state-owned entities easily purchased by foreign investors. However, large portions of the residential energy supply networks were built with local or users' contribution (e.g., Action Z in Slovakia, users' associations in Hungary). Local governments could claim some compensation for their shares only with significant delay and in cash or shares. In Hungary, this was achieved only through a decision by the Constitutional Court.

2.3.4 *Social Housing Units*

Social housing stock and apartments were easily transferred to local governments, because they were built with local funds, they were located within the boundaries of the municipalities and local governments hold the responsibility to provide social housing. Often, housing units belonging to former state-owned companies were also transferred to municipalities. Local housing was rather uneven—some units were easily sold to tenants; other parts were retained by municipalities. In both situations, reconstruction and operational costs were rather high. Consequently, local governments remained responsible for housing policies, even in a privatized environment. They had to develop new housing schemes and introduce local social policy measures.

2.3.5 *State-owned Enterprises*

There were two basic issues regarding this group of assets: (i) transfer and privatization of small services and manufacturing companies, (ii) allocation of shares from privatization to local governments. The first was solved as part of the small-scale privatization process. Local businesses (shops, restaurants, repair shops, etc.) were privatized or transferred to local governments and excluded from privatization (e.g., in Slovakia). In other cases the owner municipalities had only limited influence, because privatization had been started before the new local governments were established (e.g., in Hungary).

Of greater importance to municipalities was the privatization of state-owned enterprises. In Poland and Hungary,

local governments argued that, as they held ownership of state companies' land, they should benefit from property transfer and privatization. In Poland, where state enterprises always had excess land, local governments received no access to this reserve land. In Hungary, the Local Government Act stated that local governments became shareholders in transformed state enterprises up to the value of land; they also received compensation up to 50% of the land value. These were significant capital revenues for local governments during the 1990s.

2.3.6 Financial and Intangible Assets

As legal successors to Soviet councils, newly-elected local governments had the right to claim all financial and intangible assets of the previous owners. Cash and bank deposits were transferred to the new entities; similarly rights, licenses, contract benefits, etc.

2.4 Legal Basis of Property Devolution

The legal transfer of state property was initiated during the process of *constitutional reform*. The basic laws were usually approved or amended by new democratic parliaments after elections. Local government structures had to be legislated by the constitutions, so the general rules on municipal property were specified in amendments. This was followed by legislation on new local government systems, when specific laws—sometimes with constitutional power (e.g., in Hungary)—defined municipal property in greater detail.

In most countries, local governments became *real owners*, eliminating the earlier soft forms of usage and management of state assets. Slovakia was an exception, where in 1990 municipalities received only the right to “administer”—to manage commercial and service facilities of former soviet councils (but they became owners of assets like buildings, plots, agricultural land and forests).

2.4.1 Categories of Local Property

The basic local government laws also classified various types of local assets. Legislation identified *core property* that could not be alienated, such as public spaces, streets and monuments. Properties outside the core were subject to other laws, such as civil codes, sectoral legislation, privatization or concession laws.

In Hungary, core property was divided into two categories. Non-negotiable core property (such as roads and city parks) was distinguished from a sub-group of core assets that

could be alienated under specific conditions. Locally-elected bodies were authorized to regulate transactions on these assets (such as water networks and public buildings). This municipal discretion could be also limited by local referendum. The critical element of this legislation was the discretion it created, within a general framework, for local governments themselves to limit or enlarge their authority by collective (council) decisions.

The *actual transfer* of property was implemented in two ways: (i) by virtue of law or (ii) through property transfer committees and commissions. In most cases, the latter had only administrative and management competencies; they were merely allowed to implement laws (e.g., in Hungary). In some cases this administrative process of property identification and classification was managed by government agencies (e.g., in Latvia). Property transfer committees were primarily responsible for identifying local assets and assigning them to local governments (in the case that several governments claimed a unit).

2.4.2 Separating Land and Buildings

One fundamental legal question had to be solved by legislation. According to basic legal concepts, the fate of any structure carries ownership of the *land* below that unit. This principle was followed by most countries, with some exceptions. Local governments claimed land that, the claimed, was confiscated by the states or by state entities—often without even registering a change of ownership.

Ownership of buildings did not always include land ownership. The most evident example is Latvia, where land was first transferred to the ‘original,’ pre-Soviet owners—private persons, churches, municipalities, etc.—while buildings might have different owners. Later, the Civil Code of 1993 made it clear that ownership of structures and land are to be connected. This relationship is reflected in Hungarian legislation, as well. It sets municipal shares in privatized companies in proportion to land value.

For this reason, land reforms were of such importance in these countries. Land ownership was of great value in these traditionally agricultural societies. The transfer of agricultural land was the most hotly debated issue during land reform. Various solutions were used for state farms, cooperatives and for compensating private landowners. Methods ranged from direct restitution to allocation of assets to workers to auction schemes.

Perhaps the most important characteristic of this legal process is that *several stages* of property transfer can be identified. In Latvia, it began with ‘nationalization’—public property had to be created together with the reestablishment of the Latvian state. Devolution could be started only after

local functions and competencies had been identified. Regulations on restitution and privatization were subjects of separate pieces of legislation, not to be confused with rules on property devolution to local governments.

2.5 Transfer of Public Property

Following the complicated legislative process, the next step was the implementation of these laws and regulations on property transfer. This enormous task involving transfer of thousands of property units from the state to local governments required the support of administrative procedures and specialized organizations. The first job was the identification of assets, followed by the actual legal transfer, settling potential disputes at the same time. This lengthy process was managed in different organizational settings from country to country.

In Latvia and Slovakia, the actual property transfer was *managed by the public administration*. National government agencies collected information and made inventories on state-owned assets to be transferred to localities. In Slovakia, 'protocols' specified units transferred to local governments. They were signed by mayors and a representative of the local administration. Commissions were set up only for land transfer (in Latvia) and for privatization (in Slovakia).

In Hungary and Poland, the administrative process was *managed by committees or commissions*. They had administrative duties, but the huge task of property transfer was supported by joint bodies from various organizations. In Poland, the voivod administration was responsible for issuing decisions on municipal property, supported by lower level local government (*gmina*) inventory commissions. In Hungary, a specific law forced the government to set up 13-member councils based on property transfer committees, which were to designate each unit of property.

Bodies administering legal resolutions were needed because property transfer was accompanied by fevered disputes, as several local governments were involved in many cases, and the basis of property transfer was often unclear. In Hungary, the forum for appeals was the Ministry of Interior; second appeals were heard in court; in Poland, appeals went to the National Enfranchisement Commission.

Members of property transfer committees had to fulfill their obligations in addition to their ordinary work. Civil servants supporting the committees were assigned only temporarily. County-based property transfer committees cooperated with municipal working groups; otherwise they would not have been able to manage this enormous task. There was no real administrative support for these committees. After five years, when the committees had almost completed their job, their members were decreased to four. Later, in Hungary, they ceased to exist.

The most critical element of managing property transfer was a reliable and accurate inventory of public assets within the territory of a local government. Municipalities were interested in establishing reliable local property *cadastres*, as it formed the basis of their claims and disputes. At the first stage of the property transfer, it was a simple inventory of buildings, equipment and other tangible assets. This served as the basis for registration (usually free of charge) or protocols signed by interested parties.

More sophisticated inventories (e.g., for accounting or investment purposes) were set up only at a later stage. That is why the valuation and assessment of transferred property was not really an issue. The profession of assessors also had to be gradually developed during these years, when privatization was sped up and more precise information on state-owned assets was required.

There was another specific problem related to local government property transfer: *churches* claimed assets confiscated during the decades of communist power. As churches had provided public services (education, health care, social services, etc.), they were at times in conflict with local governments. In Hungary, churches received all the property needed for delivering their services—not only religious activities but public services as well. If they guaranteed that services would continue, they were eligible for certain confiscated buildings. In case of disputes, special conciliation boards were set up with local government participation.

2.6 Scale of Property Devolution in CEE Countries

There is no comprehensive statistical and fiscal information on property transferred to local governments. It was not possible to survey the status of local government assets before devolution has started. Data on actual transfers mostly concern physical characteristics (area, number of units) of land, housing, buildings, etc. Transferred municipal property was definitely a new type of asset for local governments, bringing additional revenues to local budgets. It also opened new, indirect revenue-generating opportunities for local governments through local economic development and privatization or commercialization of municipal companies.

One of the most visible changes in ownership structure has been in the *housing* sector. Social housing became municipal property with the transfer of former management rights to real ownership. Most countries in Central Europe tried to build up the private housing sector by selling or transferring municipal apartments to tenants. At the beginning of the 1990s, various forms of public housing (state, municipal, cooperative, company, etc.) dominated the sector (50-60% of total housing¹). By the end of the decade, it

was decreased to 26-50% (the lowest in Slovakia and the highest in the Czech Republic)—a major stock of assets. However, this process of privatization did not bring significant revenues to local governments, because the net value of these assets was rather low, due to deferred maintenance during past decades.

The transfer of *communal and utility companies* had a more significant and positive impact on the balance sheet of local governments. In the water sector, former large state companies were broken up and transferred to localities: the number of new local entities increased from 33 to 400 in Hungary, from 50 to 713 in Poland.² Similar restructuring happened in the solid waste management sector and in district heating services (in Poland 55 regional state companies were transferred to 600 municipalities).

Property transfer had a significant impact on local government balance sheets. As the first step of property devolution was the transfer of physical assets to municipalities, real estate dominated the local balance sheet (in Latvia 6% of real estate, measured in surface area, became local). In Hungary real estate dominated local governments' balance sheet (1991: 58% of assets, while shares and dividends formed only 2%). Later, when the transformation of companies had been launched, shares and dividends became more significant forms of assets (1994: 31%, while the proportion of real estate decreased to 36%). This raised local budget revenues and made the relationship between municipal owners and service organizations more indirect.

Property-related local revenues also indicate the significance of municipal assets. During the past decade of fiscal restrictions, municipalities were able to fund capital investments mostly from privatization revenues. Sale of their own assets (buildings, urban land), revenues from privatization of state-owned and municipal enterprises resulted 2–3% of local budget revenues each year. However, this relatively steady revenue flow tended to dry up at end of the decade.

2.7 Municipal Property Management

New types of local government assets and extended municipal responsibilities in property management forced local governments to modernize their management forms and practices. In most CEE countries, decentralization resulted in a greater degree of autonomy concerning local property and gave freedom in designing forms of service delivery. Local governments had the right to utilize private incentives, build up new relationship with businesses and make decisions on the financial and management rules of their own assets. This local autonomy was limited by national regulations and local internal rules of operation.

2.7.1 Limitations on Local Decisions

The most important area of national legislation is the limitation of local autonomy on *changing categories* of municipal property. Conditions for using a public (e.g., school) building for other purposes has to be clearly regulated. Studied countries followed different practices. In Hungary, for example, where general authorization was given to local governments on some groups of assets (e.g., core assets with limited negotiability), while specifying the required procedures for moving assets among groups of property (council decisions are needed to change the use of a property). Another solution was to give authorization to higher levels of government (to voivods in Poland; 'authorized' bodies specified by sectoral legislation in education and social services in the case of Slovakia).

There were other general limitations on local *historical* buildings and units of cultural or natural value. Another set of regulations limited local property management autonomy over *entrepreneurial activities*. Local governments had to have limited liability for protecting their primary public service functions. Using local assets as collateral for loans or issuing guarantees for municipal service organizations might also be limited. Rules could be set by general laws (e.g., on municipal debt burden in Hungary) or a decision might be taken on a case-by-case basis by national ministries (e.g., in Latvia).

2.7.2 Audit and Transparency

Greater autonomy in local financial and property management raised the importance of audit practices. New forms of local government operation should be subject of regular external audit and the forms of control should also be adjusted to new local conditions. In general, the function of audit has changed, because only the legal compliance of municipal decisions can be audited. In the area of property management, an audit might be focused on the use of property (Poland) or on the appropriateness of municipal reports (Hungary). This increased task of the national audit system has resulted in new forms of audit (e.g., obligation to use private audit reports for large municipalities in Hungary) and increased the significance of internal audit and control practices.

A critical element of local regulations is the *assignment of property management authority* within a local government—authorizing the elected council, its committees, the mayor or the municipal administration to make specific types of decisions on local property. Usually the type of transactions (sale, lease, rent, etc.) and the value limits are specified by regulations.

Thus, local autonomy led to higher *transparency* in local property management. Procurement and tendering regulations are set by international standards and national laws. Local government could supplement them by setting the rules for transaction below the national thresholds and specifying the internal procedures. For decreasing the possibilities of conflicts of interest situations in local decision making codes of ethics and detailed procedures (for committees, municipal officials and for the staff) should be designed and enforced.

2.7.3 Financial Techniques and Organizational Forms

In the area of financial management, special *techniques* might improve municipal property management practices. As one of the most frequent mistakes in property management is the use of property-related revenues for operational purposes (under the current budget), earmarking asset-related revenues could prevent these practices. Separation of current and capital budgets (both revenues and expenditures) by force of national legislation is a common solution. But local governments can also set up their own internal rules for capital revenues or they might introduce fund accounting practices, which would allocate property-related revenues to special purposes.

In the early stage of property transfer, local governments had to establish new *organizational forms* of local property management. The former general purpose ‘city management’ companies were split into smaller entities or property management was taken back by the municipal administration. Contracting out property management of financial assets was common. Property management companies had to establish their own accounting (e.g., on depreciation) and budgeting practices. The emerging new forms of public-private partnership also demanded new expertise and capacities from staff and management of these municipal companies. Hence, *municipal professional capacity* in property management had to be developed relatively quickly.

2.8 Related Issues

Devolution of public property to local governments is not solely a legal action, when constitutional rules and municipal legislation are changed. Beyond these highly political steps, which would require general public support, there are several other conditions for establishing an efficient and transparent system of local government property management. Without creating a legal and administrative environment

and institutionalizing new practices, property devolution does not benefit local governments. Without ranking these external conditions, the most important pieces of legislation are, as follows:

- a) Legislation on commercial entities within the public and private sector (a *Company Act*) should clarify the basic rules of operation for businesses. These general rules will support local governments as they develop their own internal mechanisms of property management.
- b) *Privatization* is usually implemented parallel to property devolution. For local governments, it should be clear from the first moment what their legal options are as new owners of former state-owned public utility companies. It is also critical to specify the proportion to which of privatization revenues, especially in those unique instances when local government had a financial stake in transformed companies (e.g., in the energy sector).
- c) As local governments became owners of urban land operating in a market environment with various private business actors, the purposes and functions of urban planning changed as well. *Land use* (zoning) regulations and an *urban planning* system must be adjusted to these new conditions, otherwise local government cannot benefit from their property. Greater autonomy should be given to developers, but investments should be indirectly regulated through new forms of urban planning. This shift in traditional municipal planning activity requires much time and would require changes in the mentalities of both among urban planners and local councils.
- d) Finally, economic and *financial regulations* had to be adjusted with this new environment. Local governments will benefit from their property only if they enjoy greater autonomy in setting user charges and levying property-related local taxes. Property devolution is part of the general fiscal decentralization process. As property revenues might increase differences among local governments, they might be considered important factors in the design of intergovernmental transfers.

3. LESSONS FROM PUBLIC PROPERTY DEVOLUTION POLICY

Based on the experiences of selected countries in Central Europe, this section will attempt to provide a *checklist* for property devolution policy design. Issues listed below are reflections on lessons drawn from the previous sections. As the countries studied also followed different property transfer practices, this list is a tentative proposal for policy makers in countries tackling public property devolution.

3.1 Changing the Legal Framework

3.1.1 *Building Political Consensus*

As property-related decisions are critical to transition, they should be based on political consensus. However, as all political actors clearly understand the significance of property transfers and the long-term economic implications of these decisions, this consensus-building is rather difficult. Property devolution should be part of a general decentralization strategy, which might enjoy broader political and social support. Property is mostly a question of economic power, so promoters of property devolution will confront not only inherited communist values, but representatives of the emerging market economy and their allies in national agencies.

3.1.2 *Legislative Process*

Formation of new public property should be based in constitutional law. Basic laws on the future of the state and the role of the public sector should lay down the conditions for specific laws. More detailed legislation can identify the competencies of local governments, rules and procedures of actual property transfer and the broader regulatory environment. In transition countries that have not completed property devolution, land ownership can be a critical issue. Land codes might be the basis of municipal property reforms. During this legislative process, the relationship between land and buildings should be clarified (whether they share the same status or not). Property devolution might be implemented in several stages (nationalization, devolution according to transfer of functions, commercialization and privatization of local/public entities).

3.1.3 *Restitution, Privatization*

After a decade of political changes, countries still addressing property devolution will be faced with the problems of privatization and restitution. Decentralization of property should be implemented in the context of privatization—as new owners, local governments must follow the same rules. Restitution claims should be rejected on transferred public property, and local governments have no right to claim compensation for municipal property confiscated earlier.

3.2 Issues in Property Transfer

3.2.1 *Identifying Local Property*

Local governments should receive assets related to the public services provided by them. This functional approach may be legislated gradually, in order to ease implementation. Categories of local property should be clearly identified by legislation listing all types of assets. This can be supplemented by the categorization of local property, separating core public assets from municipal property which local governments have greater autonomy to use, sell, etc. Specification of assets remaining in state ownership will also help in the long run.

3.2.2 *Inventory and Registration*

The cadastre of public property is critical. Local governments have to know which units are unquestionably under their control. However, in many transition countries, these inventories are not available, so information on transferred property will not be perfect. This fact should not prevent decision-makers from initiating devolution, as it is likely that most assets can be identified with little dispute.

3.2.3 *Administrative Procedures*

Property devolution policy should take the lack of perfect information on public assets into consideration. Administrative procedures should be adjusted to give greater autonomy to central-local negotiations (e.g., in the form of property transfer committees) or by improving inter-ministerial coordination and leaving room for dispute resolution (e.g., setting up commissions).

3.2.4 *Timing and Speed of Property Transfer*

The process of property devolution might take a long time. There is a need for setting a reference date for legal debates and to set a final deadline for completing the process. In countries of Central Europe, the reference date was connected to the communist takeover, and usually five to six years were sufficient to manage the devolution process.

3.3 Special Issues

3.3.1 *Missing Rules and Regulation*

In many transition countries, several components of fiscal decentralization have to be developed parallel to property devolution. Local governments are not able to benefit from their increased municipal stock of assets if they lack basic financial and management competencies. They have to receive authority from public utility companies (selling, restructuring, etc.) to set user charges and other local own-source revenues related to property. Rules of contracting out, lease and concessions are also critical to local autonomy. As local governments enter into public-private partnership arrangements, these rules have to be modernized as well. This requires changes in urban planning from direct control of plots to a zoning-based land-use plan.

3.3.2 *Improving Local Capacity*

Local governments have to learn methods to manage newly transferred property. In the slowly emerging market environment, local organizational forms of property management should be established, and both municipal staff and service organizations must develop greater professional capacity. This institutional and capacity development process requires new forms of audit and internal mechanisms ensuring higher transparency in local government.

3.3.3 *The Future of Self-managed Service Organizations*

In many countries still faced with large-scale property devolution, service organizations are still controlled by 'self-management' bodies. These management forms, inherited from the communist period, are mixed bodies of owners, employees, users and sometimes even representatives of government agencies. Within the general process of decentralization, these 'corporatist' forms of management should be shifted to elected local governments. This will improve the efficiency of property management practices, because elected general purpose local governments have greater legitimacy and more comprehensive development strategies.

3.4 Managing the Reform Process

The property devolution process should be based on a consistent legal framework. Constitutions should clearly set the foundations of local government ownership and specific laws

have to outline or define administrative techniques and implementation methods of property transfer. This legal reform is closely related to other elements of decentralization, so it is an extremely complex legal process.

Actual property transfer can be started before all the specific conditions of the legal environment are in place. Assuming that the basic rules are set and there is a political consensus over the necessity of property devolution, many unregulated problems can be solved in practice. It is more important to initiate the property transfer process in less controversial areas (e.g., transferring public service units and municipal companies), than waiting until all potential elements of local property are identified (land, infrastructure, etc.).

It is also advisable not to wait until all administrative circumstances are available (e.g., a precise property cadastre), because most cases can be managed in incomplete conditions. Local governments which are most interested in property transfer will find solutions (e.g., collecting information, providing evidence) for cases that might be debated because of imperfect rules or procedures.

However, it might be useful to examine whether the property transfer process is manageable. *Pilot cities* or *experiments* can help design the general process and check the feasibility of devolution concepts. In the countries studied here, there were no such examples, because most had to launch property transfer in the early stages of transition, when the political climate was favorable. Still, a learning process took place, as local governments were authorized to arbitrate over communal company transformation until a certain date (Hungary, Slovakia), or they were given the right to 'opt out' of public schools from state to local governments (Poland). Countries under lower political and financial pressure might design their property devolution policies by implementing pilot programs.

Finally, as for any major policy change, *publicity* for property transfer programs is a basic requirement for successful reform. Interested local governments, ministries and service organizations and the general public have to be informed about the rationale and legal process of property devolution. Decentralization of assets will be more acceptable when all regulations and practical consequences are known and understood.

NOTES

¹ Lux, M., ed. 2003. *Housing Policy: An End or a New Beginning?* Budapest: OSI/LGI, 2003.

² Péteri, G. and Horváth, M.T. eds. *Navigation to the Market*. Budapest: OSI/LGI, 2001.



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1. LOCAL GOVERNMENT IN HUNGARY

1.1 Legal and Constitutional Basis

1.1.1 Establishment of Local Governments

In 1990, a new system of local democracy was established in Hungary which respected both local traditions and the European Charter on Local Self-Government. After issuing Act 64 of 1990, the new local governments began to operate in the autumn of 1990. The former system of local public administration—a centralized hierarchy of local councils based on the Soviet model—was unsuitable for the strengthening of local democracy.

The Constitution and the Local Government Act gave local communities, including the smallest settlements, the right manage local public affairs; at the same time increasing the number of local territorial units to 3,149. Local government representatives and executives were elected by the local residents.

The local government system was given a legal basis by Chapter IX of the Hungarian Constitution. Local self-government is defined as the autonomous and democratic management of local public affairs and the exercise of local public authority in the interest of the local population. Eligible voters exercise their right to self-government by directly electing a body of representatives, the rights and duties of which are determined by Parliament. The lawful exercise of local self-government is protected by the judicial system; in the event of a conflict, any local government may appeal to the Constitutional Court.

The overall territorial division of Hungary is fixed by the Constitution. It is divided into counties, cities, communities (villages) and the capital city, which is divided into districts. At the same time there is administrative division. Local governments are constituted in settlements, counties, as well as in the capital and its districts. The organization of local public administrations (local branches of the central administration) and other bodies such as courts, generally respect this system of territorial division, with some excep-

tions defined by specific tasks (such as those of regional administrations).

1.1.2 Local Government Systems

There are two major categories of local government in Hungary: municipal and county. The basic elements of the system are the municipal governments in settlements—including villages, cities and cities with county status. The middle-tier of the local government system consists of the 19 county governments which serve as regional local governments. The capital city, Budapest, has a special legal status.

There is no hierarchical relation between the two levels of local government. As the Constitution declares, the fundamental rights of local governments are equal; only their duties are different. County governments do not have the right to interfere in matters delegated to municipal governments. This is seen in the division of duties between the two levels: municipalities provide local public services in each settlement; counties have a subsidiary role in that they provide public services with regional impact.

Settlement governments have broad responsibilities to provide public services. They may undertake any local public activities not prohibited by law. There are two categories of tasks performed by local governments: optional tasks and mandatory tasks. The Local Government Act determines the functions and powers for local governments to discharge. Simultaneously, parliament must provide the financial means necessary for such purposes.

The role settlement governments take in the reform of local public services is defined by the Local Government Act, falling into the optional category of local government activities. The act does not prescribe a list of tasks to be performed exclusively and obligatorily. Local governments may freely undertake such tasks. Settlement governments may determine these tasks on the basis of the requirements of the population and the financial means available.

The same act fixes obliges local governments to provide certain public goods and services—healthy drinking water, kindergarten, primary school education, basic health and welfare services, public lighting, maintenance of local roads

and public cemeteries. Settlement governments are further charged with protecting the rights of ethnic and national minorities. The provision of these public services by each settlement government, including the smallest village, is mandatory.

Major cities (cities with county status) may enjoy a special legal status as fixed by the Local Government Act, which also defines the procedure for obtaining this status. Such city governments, as well as fulfilling all the responsibilities of settlement governments, are assigned additional tasks and duties which reflect their status as counties. The cities' territories may then be subdivided into districts with district offices, etc.

Autonomy for counties is a tradition reaching back several hundred years in Hungary. This is one reason this level was created during public administration reform. The Local Government Act of 1990 assigned counties subsidiary roles in the provision of local services. Later modifications to the act changed this. Legislation in 1994 defined counties as regional self-governments, still with secondary roles in the provision of local services, but with certain duties not assigned to settlement governments. Legislation may require county governments to provide some public services of regional character, applicable in all or a large part of the territory. Legislation may also demand the organization of public services of regional character, even when the majority of the beneficiaries do not live within a government's territory. The Local Government Act does not provide a list of mandatory tasks for county government, instead providing examples of possible activities.

The capital of the country has always had a particular legal status. In 1994, the Act on the Local Government of the Capital and Its Districts (originally approved in 1991) was modified, eventually becoming Chapter VII of the Local Government Act.

Budapest has a two-tier local government system consisting of 23 district governments and the city government. Both tiers are settlement governments with independent functions and powers.

1.1.3 Relationships between Local Governments and Central Organs

1.1.3.1 The Relationship between Parliament and Local Governments

Parliament regulates the legal status of local governments, their exclusive functions and powers, their mandatory functions and organs, guarantees the financial resources for their activities and the basic rules of asset-management. It also regulates

the legal status of local government representatives, the procedure for their election, their rights and their obligations.

If proposed by the government and approved by the constitutional court, parliament may dissolve a local representative body whose activities are deemed unconstitutional. In such a case, new municipal elections must be called within 60 days.

The state audit office monitors the management of local government assets. The office's tasks related to local government are defined by the Public Finances Act of 1992. This act states that of local governments are to be audited particularly regarding the utilization and accounting of normative budgetary contribution, aid granted for defined objectives, consigned aid and other defined public funds.

The government ensures the legal supervision of local governments through the minister of the interior, the heads of public administration offices in the capital and the counties. It may propose that Parliament dissolve a the local representative body operating contrary to the constitution. The government also issues decrees which determine the qualification requirements for local public service, direct the discharge of state administrative functions and settles disputes between state administrative organs and local governments not in the jurisdiction of other bodies.

1.1.3.2 The Relationship between the Offices of Public Administration and Local Governments

Before the reforms completed in 1994, public administration was divided between eight regions, each including two or three counties, chaired by republic commissioners appointed by the president. Now there are offices of public administration relating to each of the territorial divisions defined by the reforms. Heads of office are recommended by the minister of the interior and appointed by the prime minister. These offices receive their budgets from the central administration and are charged with legal supervision of local governments, serving as the local contact for public administration tasks and coordinating activities between local governments and administrative organs subordinate to the central government.

1.2 Local Administration

1.2.1 Structure and Operation of Local Administration

One of the elements of self-government is the autonomous establishment of an organization to serve the local population. The administrative organization of local governments

is determined mainly by a decree on organization and procedure. This decree is proposed by the mayor or chief executive and approved and issued by the representative body. The representative body, then, establishes its own offices and departmental divisions.

The office may be divided into administrative branches (education, welfare, local economy), functional tasks (labor, finance) or types of activities (issuing licenses, direction of institutions). The office may also be distinguished between governmental and administrative tasks.

Under the Hungarian local government system, functions and powers may not be exercised directly. Representative bodies exercise the functions and retain the powers of local government, while chief executives and civil servants may retain state administrative powers. The latter is exercised by the mayor only in exceptional circumstances.

The management of the office is divided between the mayor and the chief executive. It is often said that the mayor directs the office and the chief executive leads it. The mayor directs the office in accordance with the resolutions of the representative bodies, as well as acting as the employer of the vice mayor, the chief executive and the heads of local government institutions.

The chief executive regulates the issuing of documents pertaining to defined duties and acts as the employer or public servants hired by the office. The mayor may require consultation or approval on specified decisions—key appointments, the withdrawal of such appointments and the granting of certain bonuses. Decisions on affairs of state administration are made by the chief executive, not by the mayor.

1.2.2 *Control, Auditing and Supervision of Local Governments*

Control and auditing of local government is exercised both internally and externally. Internal control is the responsibility of the representative body, carried out through the chief executive, the auditor, the financial committee and the accountant. The chief executive holds the responsibility of reporting to higher authorities if any decisions of the local representative body, its committees or the mayor violate the law. An auditor employed by the local government supervises the management of public assets.

The financial committee assesses the annual budget proposal and drafts a semi-annual report on its implementation. The committee monitors changes in budget revenues, examines justification and feasibility of any proposed borrowing and ensures adherence to cash management regulations.

The state audit supervises asset management by local governments as regulated by the State Audit Act. The gov-

ernment exercises control through the minister of the interior and the heads of county administration offices.

1.3 Local Service Delivery

Act 65 of 1990 distinguishes between mandatory and optional tasks performed by local governments.

In every settlement, no matter how small, the local government is required to provide healthy drinking water, access to kindergarten and primary school education, basic health and welfare services, public lighting and local road and cemetery maintenance. It is also responsible for ensuring the rights of minorities.

A second category of tasks are mandatory if an act determines and ensures adequate financial resources for implementation. Such tasks tend to be delegated to larger settlements and localities. All possible tasks are not specified in the Local Government Act, but many are outlined in other acts (See Annex 1).

1.3.1 *Forms of Service Delivery*

Service delivery may take several forms. Legislation states that local governments perform their tasks according to the needs of the local population and originating from their own budgets, with the support of private enterprise or other paid services. Local governments may select forms of service delivery independently.

Most frequently, the local government itself provides services. A service may be provided entirely by government institution, or it may be provided by a private enterprise under tight government supervision. According to legislation, local governments may establish cooperatives and corporate entities for the purpose of business ventures. Governments have done so to efficiently manage public property and provide park, cemetery and road maintenance.

In a second category are services provided through contract to private enterprise or entrepreneurs. In some cases a contractual enterprise might be established with a state company not owned by the specific local government. Such procedure has been used for fuel and water supplies, public transport and burials.

The Concession Act of 1991 created a new possibility for local governments to use their assets, especially publicly-owned property. In principle, concession can be utilized to finance public utilities such as water and sewage, fuel, power, heating and telecommunication. The process is complicated by the fact that these utilities are part of the larger, national system and therefore subject to state concession.

Concession by local governments, therefore, is currently possible only for water, sewage and local broadcasting.

The third form of service delivery concerns tasks carried out by association or by other municipalities. This exists only for water management and landfill operations.

1.3.2 *Alternative Service Delivery*

Along with the general process of privatization, the private sector's role in providing public services also started to develop in the 1990s. Privatizing public utilities allows capital investment from the private sector. This led to the establishment of both private and public hospitals, schools, etc.

Other significant forms of privatize enterprise include foundations, churches, civil associations and other non-profit organizations which may be contracted as public service providers. The government, in such cases, supervises and provides financing for an activity without directly implementing it.

1.4 Local Finances

Chapter IX of the Local Government Act, titled "Economic Resources for Local Governments," outlines planning, accounting and information systems as well as financing. Local governments have their own assets and manage their revenues and expenditures independently. Local governments are connected to the larger state budgetary systems through turnovers from the central government, grants, etc.

1.4.1 *Revenues*

Local government revenues include own revenues, shared revenues, normative grants and capital investment.

Own revenues mainly include local taxes and other fees imposed by the local government. Currently, local governments are allowed to impose certain taxes—on property, tourism and certain kinds of business activity—by decree.

Other revenues derive from capital gains on the government's own activity (leasing, interest, etc.) and loans from other organizations. This is primarily important for health care financing, which comes directly from the social security fund. A separate act regulates taxes on environmentally protected activities and cultural monuments. Hunting taxes may also be collected in certain territories. Local governments may also earn revenue by privatizing property or issuing loans and bonds.

The portions of central taxes shared with local governments are determined annually by the national assembly. This sharing comes primarily from the personal income tax. Motor vehicle taxes, also, are shared equally between central and local government levels.

Budgetary grants are determined by the national assembly to reflect the population of local governments' territories. Amounts are regulated by the State Budget Act and may be used without limitation by local governments.

Capital investments include targeted grants, addressed grants and deficit financing.

Table 2.1

Local Government Revenues
[in Percentage of Total Annual Revenue]

	1997	1998	1999	2000
Own revenues	23	25	25	20
Shared revenues	12	14	14	17
Normative budgetary grants	22	20	20	19
Transfers from the social security fund	14	14	14	18
Other (asset sales, loans and other state grants)	29	27	27	26

SOURCE: Ministry of the Interior.

1.4.2 *Expenditures*

The scale of local government expenditure in Hungary is exceptional due to the concentration of responsibilities, especially in the social sphere. Education, health care and welfare services are important functions of local government, while public utilities, culture and sports are mainly financed by commercial or off-budget entities. Local government expenditures include administrative expenditures, debt servicing and other economic services. As the responsibilities of local government are determined by the Local Government Act, any changes would require an amendment to this act.

The great number of social sector tasks necessitates a certain dependence on transfers from the central government. This has been the subject of debate in recent years. Grants and shared taxes formed 71% of local government revenue in 1998.

Table 2.2
Distribution of Local Government Expenditures
[in Percentage of Total Expenditure]

	1997	1998	1999
Personal expenses	28	28.6	29.2
Payroll taxes	12.6	12.8	12
Material expenses	26	26	28.3
Capital improvements and maintenance	33.4	32.6	30.5

SOURCE: Ministry of the Interior.

2. PROPERTY DEVOLUTION IN HUNGARY

2.1 Types of Property

As a consequence of transition, the system of property relations was significantly changed in recent years. These relations are regulated by the Constitution and the Civil Code.

Section 9 (1) of the Constitution declares “the economy of Hungary is a market economy with public and private ownership enjoying equal rights and protection. Consequently there are two main categories of property: public and private.”

Section 10 (1) states that “the property of the Hungarian State is national property.” Section 10 (2) goes on to say that “the scope of the exclusive property and the exclusive economic activities of the state shall be defined by law.” Thus state property is always public property, but public property is not always (centrally-owned) state property. Section 12 (2) declares that the state must respect property rights of local governments.

The distinction between state property and local government property appears clearly in the Civil Code as well. Section 1 (1) regulates pecuniary relationships between citizens, the state, local governments, economic and social organizations.

2.1.1 *Legal Status of Public Property*

Section 172 of the Civil Code defines the following kinds of public property:

- the riches of the earth;
- natural waters and waterways;
- riverbeds and river islands;
- roads, railways, international civil airports and airspace;
- telecommunications frequencies.

That the above are state property has three consequences:

- The objects are nonnegotiable.
- The objects can be owned only by the state.
- The objects cannot be owned by local governments.

Can local government property be categorized in a similar way? Is there a legal basis for the protection of local government property?

2.2 Local Government Assets and their Classification

Chapter IX of the Constitution enumerates the rights of local governments, including the following:

- the right to own property;
- the right to spend revenue autonomously;
- to enter into contractual relationships;
- to possess own revenues in conformity with the performance of tasks determined by the Local Government Act.

Section 1.5 of the Local Government Act is titled “Rights of Self-Governments,” and defines them as follows:

- the right to dispose of property;
- the right to independently manage revenues;
- the right to engage in entrepreneurial activity.

2.2.1 *Local Government Assets*

It is of particular importance to define the difference between assets and property. According to the Local Government Act, the assets of local governments comprise:

- property;
- the rights to use property (lease, copyright, etc.).

The key to self-government is financial autonomy. Even under ideal bureaucratic conditions, autonomy cannot be guaranteed without independent financial resources.

The financial foundation are assets such as property and the right to raise revenue and manage assets autonomously. Section 77 (1) of the Local Government Act establishes these rights while limiting property use to service provision.

Local governments are also given the right to initiate entrepreneurial activity, but under different conditions than private enterprise. These conditions are to avoid conflicts between different governmental activities and keep public interest as the primary objective. Local governments may engage in entrepreneurial activity, then, only as long as all

compulsory activities are provided and public property is not endangered. To this end, Hungarian legislation distinguishes between public property which must be protected against the mechanisms of the market and that which may be involved in entrepreneurial activity by local governments.

Section 78.2 of the Local Government Act defines local governments' core assets, management of which must be separately reported. The basis of this distinction lies in the assets' functions (economic development, service provision, etc.).

Section 79.1 of the Local Government Act states that core assets are those directly involved in the discharging of obligatory duties or the exercise of public authority.

According to Section 79.2, core assets may not be:

- sold;
- encumbered with debt;
- invested in enterprise;
- used for any purpose not defined by law.

Assets may be declared core assets by law or decree.

2.2.2 Core Assets

Most core assets are non-negotiable and may not pass into ownership by any other body than the local government in question, not even to another local government.

According to 79.2.a of the Local Government Act, core assets include roads, squares and parks—with some exceptions in the case of the capital city. The Property Transfer Act of 1991 includes the following in its list of non-negotiable assets:

- public waters and waterworks;
- archives related to the operation of the local government and its institutions.

Local government decrees may make other assets non-negotiable.

There are three groups of core assets that are limitedly negotiable:

- as defined by Section 79.2 of the Local Government Act—public institutions, utilities and buildings;
- as defined by the Property Transfer act—historic buildings, territory subject to nature conservation, public waters, museum property;
- as determined by Section 79.2.b of the Local Government Act—real and movable property determined by the local government.

Restrictions on limitedly negotiable assets are fixed by law or decree. These restrictions require the consent of a

third party for the conclusion of sale or turnover of property, as follows:

- For the sale of historic buildings, or for their use as collateral, the consent of the relevant minister is required.
- For the use or turnover of protected land, the relevant minister's authorization is required.
- Public water utilities may only be used for public service.
- For the sale or turnover of museum property, the approval of the minister of culture is required.

Other limitations may be regulated by government decrees which set conditions for other property transfers.

While law or decree may declare assets to be core assets, the reverse is not the case. Changing the status of an asset is possible only when an asset's function changes. The status of a road, for example, may change as the urban plan of a settlement is developed. Similarly, a public square may be zoned for construction. Further restrictions, however, come to bear on this process.

2.3 Property Transfer Process

Acquisition of property by local governments takes place in several forms. Most simply, by purchase as regulated by the Civil Code. This was not common, however, during transition in Hungary. When the local government system was established in 1990, most assets were transferred from the central government to serve as the economic basis of self-government.

Most such transfers were made by the Local Government Act of 1990, later by the Property Transfer Act of 1991.

Although the transfer of property has not ceased, a significant portion of properties to be transferred have already been turned over to local government.

2.3.1 Property Acquisition by Virtue of Law

Ex lege acquisition of property was ordered by the Local Government Act of 1990 and by the Property Transfer Act of 1991. Three groups of property may be designated as objects of *ex lege* acquisition.

- 1) Section 107.2 of Local Government Act determined the first group of property objects transferred to local governments—all state-owned property previously managed by councils, such as:
 - real estate;
 - forests;
 - waters, with the exception of protected areas, buildings or art monuments;

- cash;
- securities.

This property was transferred by the Local Government Act of 1990 and was not regulated by the Civil Code. It was an occasional act changing the property nexus of significant groups of property.

- 2) The second group of property transferred *ex lege* to local governments was particular—the property of the common councils of several settlements. Under the Soviet system, certain groups of settlements were controlled by a joint council. In the process of reform, many settlements were divided out of these groups. Property belonging to these joint councils, then, had to be shared accordingly. The representative bodies of such settlements were given until December 31, 1990 to settle these issues.

Because the Local Government Act did not regulate the sharing of previously jointly-owned property, this was regulated by the Civil Code. Property was transferred proportionally, stating that if in doubt, property shares of the co-owners were equal.

- 3) A third group of property transferred *ex lege* to local governments was regulated by the Property Transfer Act. These objects were tenements and other structures managed by councils' communal management enterprises. Such properties, with some exceptions, were transferred to the local government in whose territory they were found.

Flats and buildings managed by organs of the state remained state property. If a building managed by a communal management enterprise was used by local governments itself or by its public enterprise or institution, it was transferred by the property transfer committee. Tenements and other structures co-managed by communal management enterprises or other state organs (for example, flats managed by a communal enterprise in a state-owned building) were not transferred to local governments.

Overview of objects of property transferred *ex lege* to local governments:

- 1) As of September 30, 1990

- public roads and their facilities including subways, overpasses, bridges, sidewalks and bus-stops;
- public parks, playgrounds and playing-fields;
- public squares and public works of art;
- public cemeteries;
- cultural institutions;
 - kindergartens;
 - primary schools;
 - student hostels;

- libraries;
- cultural centers;
- central workshops;
- artist colonies;
- museums;
- theatres;
- music schools;
- youth camps;
- pedagogic councils;
- pedagogic institutes;
- specialized secondary schools including those for part-time students;
- vocational schools;
- specialized schools for health;
- educational institutes and student hostels for the handicapped;
- archives;

- health and social welfare institutions;
 - panel doctor's offices;
 - panel doctor's offices for children;
 - medical specialists' offices;
 - maternity centers;
 - nurseries;
 - housing and organizations for the elderly;
 - homes for the handicapped;
 - family-assistance centers;
 - regional health-care facilities including hospitals, clinics, sanatoria and blood banks;
 - homes for children;
 - homeless shelters;
- sports institutions;
 - sports halls;
 - centers for leisure;
 - sports fields;
 - swimming pools;
- other institutions;
 - tourist offices;
 - continuing education centers;
 - fee-collection offices ;
 - zoos;
 - driving schools;
 - local government offices;
- tenements;
- lands;
- forests and waters;
- cash and securities.

- 2) As of September 1, 1991

- tenements and other structures.

2.3.2 *Property Acquisition through Property Transfer Committees*

The Local Government Act authorized the government to establish property transfer committees in counties and in the capital. These committees administrated the following properties:

- state-owned lands, forests, real estate and waters as defined by the Property Transfer Act;
- protected territories, buildings, structures and other monuments;
- public utility facilities;
- the assets of public enterprises established by councils.

The basic principles of the Property Transfer Act were as follows:

- The property of dissolved councils became local government property, transferred without recompense. This included all properties managed by councils and their organs as well as institutions and public enterprises founded by the council for public service provision.
- Local governments were expected to agree on the proper transfer of property, with the ultimate authority in the hands of the committee.
- Property was transferred according to the requirements of managements and assigned responsibilities.
- Local governments were not required to accept ownership of transferred property if its management or maintenance would incur extra costs.
- The process of recording real estate ownership in the land registry was simplified.

2.4 **Transfer of Different Types of Property**

2.4.1 *Buildings*

Buildings used by local governments were transferred to the respective government. Some buildings were used by several government institutions or enterprises, and transfers were then supervised by the transfer committee. Many buildings which were only partly used by a local government were entirely transferred. If a building used by a local government was not used to provide services, and the competent minister asked for management rights, the committee did not transfer ownership to the local government. The principle here was that property must be owned by the organization responsible for public service or public authority.

2.4.2 *Monuments*

The Local Government Act declared monuments to be the property of the local government. Such properties were transferred if the local government's legal predecessor (council or organization) had owned the specified monument. The approval of the environmental minister was also required, as regulated by the 1985 Treaty of Granada ("On Protection of European Architectural Heritage").

Monuments which had been managed by joint councils were transferred to the local government if significant investment had been made since January 1, 1975 or if several local governments used the monument.

2.4.3 *Protected Territories*

Special regulations had to be applied to ensure the protection of certain territories of national interest regardless of their ownership. In some cases the high cost of maintenance or the need for special expertise relegated ownership to the central government. If the environmental ministry deemed this necessary, the local government could claim compensation.

2.4.4 *Land*

The Local Government Act transferred lands and forests previously managed by councils and their institutions to local governments. The Property Transfer Act regulated transfer of lands and forests managed by public enterprises, in urban areas or used by cooperatives.

Lands managed by public enterprises include:

- construction sites and lands under cultivation;
- companies involved in public enterprise activity;
- lands managed by public enterprises, public squares and public utilities.

Urban lands not specifically slated for state ownership were transferred to the respective local government. Exceptions were determined by the State Property Act as follows:

- vacant lots in urban areas managed by the central government;
- lands attached to another unit (such as the garden in front of a factory);
- vacant lots managed by state enterprises in the process of being privatized;
- vacant lots in urban areas in the case that a building permit was issued before the Property Transfer Act went into effect.

All lands not managed by enterprises included in the list of exceptions were transferred to local government. If the terms of the Property Transfer Act were met, committees had no discretion over their transfer. An application process was created so that local governments could know exactly what properties were in question. Managers of public utilities could also apply to the committee to continue their management responsibilities under the new ownership. The committee was required to define management rights and restrictions.

Section 108 of the Civil Code states that a real estate owner is required to allow authorized bodies to temporarily use the property to the extent necessary for the performance of their professional tasks.

The Civil Code further gives owners the right to compensation based on any hindrance, restriction or damage to property. Special rules were applied to properties of primary significance in the capital. The capital's property transfer committee received applications from district governments for the transfer of such properties.

2.4.5 *Compensation for Land in Urban Areas*

If urban real estate managed by state-owned companies was sold, the local government was entitled to 50% of the purchase price. If the land was left to a commercial entity, the local government was entitled to the entire value. The same rule was applied in cases when vacant lands managed by state-owned companies were given to a company and the Property Transfer Act did not allow property to be transferred to local governments. This rule was applied when a state-owned company in transition left only a portion of its real estate to the transformed company.

Another rule was applied if the entire state-owned company was transformed. The Transition of Companies and Economic Organizations Act determined that local governments with territorial competency were entitled to a share equivalent to the value of urban land belonging to the company being privatized.

Special regulations in the Property Transfer Act were applied in the capital. The value of urban lands were given either to the city government or district governments or shared 50–50% between them.

2.4.6 *Property of Public Enterprises and Public Utilities*

Section 107.1 of the Local Government Act regulates the transfer of the following properties to local governments:

- property of state-owned public service providers;
- property of budget agencies;
- shares deriving from the transformation of state-owned organizations;
- public utility facilities and equipment in urban areas except those exclusively held by the state;
- property of state-owned economic organizations established for public service provision by councils and being under councils' supervision.

Economic organizations are described in the Civil Code. Their economic activities were enumerated in the State-Owned Company Act of 1977.

Public companies were transferred to local governments if the companies:

- were established by the legal predecessor, the council;
- were established by ministers and transferred to a council;
- were under a council's supervision when the Local Government Act went into effect (companies which had been nationalized).

Activities of public companies transferred to local governments:

- water, sewage, public baths;
- central heating and hot water supply;
- public sanitation;
- maintenance of gardens and parks;
- chimney-sweeping;
- burials;
- communal and real estate management;
- cinemas and other cultural services.

A) *General Rules Concerning Transfer of Public Companies to Local Governments*

Generally, all property owned by public companies was transferred to local governments except for monuments, nature reserves near settlements and buildings previously owned by churches.

The Property Transfer Act distinguishes between equipment and facilities owned by public utilities and other property known as "non- public utility" property. This second group includes:

- property necessary for a company's activity (such as a cinema hall), called "operational property" by the Property Transfer Act;
- line facilities;
- rights of property value;
- property connected to entrepreneurial activity.

The Property Transfer Act transfers ownership of public utilities to the local governments of the settlement where the service is provided. In cases where the local government did not apply for exclusive ownership, property was transferred either to surrounding governments or to the higher (county) level.

From among objects of “other property,” operational property could be exclusively transferred to the concerned local government. Objects of operational property involved in service provision in several settlements were transferred to group of settlements’ governments or the county governments.

Rights of property value, shares and entrepreneurial property were transferred to local governments by agreement. Without such an agreement, property transfer was realized proportionally to the benefit to the given public service. If property of public utilities was transferred to county government, rights of property value, shares and entrepreneurial property were transferred to county government in proportion to the service provided by the public utility.

Property transfer committees had to make individual decisions on the maintenance of the public company, on the transfer to local governments of the public utilities managed by the public company and on the transfer of the other objects of property of the public company. Consequently, local governments could agree on each property element one by one.

Because of the special activities of certain companies previously owned by councils, their location or specific safety concerns, special rules were applied to the transfer of their property

B) Special Rules Concerning Transfer of Public Companies Satisfying the Needs of Several Local Governments

1) Transfer of Public Utilities

Property transfer distinguishes between utilities serving one or multiple communities. Utilities serving a single community are transferred to the settlement in question. In the second case, the application process through which settlements could apply for partial ownership of a utility were administrated by the property transfer committee. If a local government did not apply for partial ownership Section 107.6 of the Local Government Act called for an agreement between settlements in question.

2) Transfer of “Non-public Utility” Property

According to the Property Transfer Act, such property must be transferred if the following conditions are met:

- The property exclusively serves the needs of a single settlement.
- The property can be technically separated from the council’s property.
- This separation does not jeopardize service provision in other settlements.
- The local government applies for it.

The same rules were applied if a public company did not manage public utility. In such cases, the regulation concerned the part of the property having a direct role in service provision.

If all these conditions were not met, Section 107.6 of the Local Government Act transferred the property to the local government of the settlement. If concerned settlements could not come to an agreement, property was resolved into joint ownership or transferred to the relevant county government.

If all the above mentioned conditions were not met at the same time, not public utilities had to be transferred to local governments applying Section 107.6 of Local Government Act. If the concerned local governments could not agree on it, property was transferred to joint ownership of settlements or county self governments. If a public company founded by a council was transformed into a commercial enterprise, ownership of shares was transferred to local governments in the same way.

C) Special Rules Concerning Transfer of Certain Objects of Property of Council-owned Companies

In order to avoid conflicts between local governments and to assure the safe functioning of public companies, special rules were applied to the transfer of property of public companies.

Upon request by a local government, a decision was made by a property transfer committee on transfer of public and open baths used and managed by public companies or councils.

The property of a public company providing communication (traffic) service *ex lege* had to be transferred to the local government.

A cemetery managed by a council or public company and located on state-owned land had to be transferred to the settlement government (or district government in the capital—where the rules of burial could be regulated by a city government decree).

The property transfer committee supervised the transfer of public railways (including tram, metro, suburban railway and funicular) and trolley-buses as well as their facilities

to the relevant local government. If the facility connected or crossed several settlements, it had to be transferred to the local government who managed and maintained the system.

A building or part of it managed by the communal management company of a local government and used by a public company from another local government had to be transferred to the local government that maintains the public company which uses the building. This rule was based on the principle that property being necessary for the provision of a public service had to be transferred to the local government providing the service. This provision did not cause problems in cases when a public company provided service only in one settlement or in the capital. The situation was different if the public company provided services in several settlements, as the local government supervising the public company does not always own the property. If the ownership of the building managed by the communal management company of a local government but used by a public company had been transferred to the ownership of the communal management company, this would have contradicted the purpose of the property transfer. Consequently, decisions on transfer could have been made only after the decision on the transfer of the public company's property was made and the local government's founder's right was designated. Local governments exercising founder's rights were entitled to ownership of the public company's property, consequently ownership of the building used by public company (but managed by communal management company) had to be transferred to these local governments in proportion to the benefit of a specified public service.

D) Special Rules Applied to Transfer of Property of Public Companies Functioning in the Capital City

Generally, the Property Transfer Act deemed that a public company owned by a city or district council must be transferred to the local government exercising founder's rights. There were three exceptions:

If a council-owned company provided services in more than one district, the property transfer had to be based on agreement between all districts concerned. If no agreement could be reached, ownership would be resolved proportional to the service beneficiaries.

If a council-owned company provided services for other settlements or districts, the company would be jointly owned by the effected settlements.

National roads and their facilities, bridges, subways and over passes—except those belonging to the national highway system—were transferred to the capital city government.

E) Transfer of Property of Communal Management Enterprises

These enterprises were in a special situation. The property they owned or managed could be categorized into two types: registered property and committed property. Committed property included flats and other real estate the management of which was assigned to a council. These committed properties were transferred *ex lege* to the local government.

Registered property of a communal management enterprise was generally also transferred *ex lege* to the local government, but its territorial competence depended on the location of the object. If a building was used by a communal management enterprise, it had to be transferred applying the special rules on property of public companies.

Undeveloped land owned by communal management enterprises was also generally transferred to the respective local government. Specified forests and parks were transferred to the capital city government.

2.4.7 Public Waters and Water Systems

Smaller water courses touching the administrative boundaries of local governments were transferred to these governments. Some smaller branches of the Danube with a less significant role in transport were also transferred to local governments.

Natural standing waters were transferred to the relevant local government as long as the waters were not in direct connection with waters in another jurisdiction. Certain larger and more important lakes were not transferred to local governments due to their important role in water management and ecology. Waters forming the boundaries of the country were not transferred.

Waters and waterworks are considered core assets of a local government and therefore nonnegotiable.

2.4.8 Regional Water Utility Companies

Because of their larger territorial scope, regional water systems were generally not transferred to local governments.

2.4.9 Transfer of Other Objects of Property

Council-owned movable property was transferred *ex lege* to local governments by Section 103.3 of the Local Government Act.

Special rules regulated the transfer of museum property. Previously, all museum-value objects had been state-owned. Property was then transferred, if possible, according to the will of the donor. Otherwise, property was transferred only if it had been purchased directly by the council.

2.5 Special Problems of Property Transfer

2.5.1 *Local Government Compensation*

Property transfer, as regulated by the Local Government Act and the Property Transfer act, formed part of the process of privatizing the socialist-era command economy and forming the economic basis for self-government.

The transformation of state-owned companies was regulated by the Privatization Act of 1989, following the Act on Economic Societies of 1988, which had fixed forms of incorporation and joint ownership. Under the Act on Transition of Companies and Economic Organizations, a part of the value of urban lands owned by state companies were transferred to local governments. Thus, the state income derived from privatization were shared with local governments.

In many cases, however, companies being privatized were bankrupt and their only value was the value of the urban lands. If the land value was contributed to the transformed company's capital, the entire amount was received by the local government. Several times between 1991 and 1992, local governments had required the courts to force the central government to turn over this value. Starting in 1992 other systems of calculating privatization value were used. first by comparing a company's value to the value of land owned by the company. The Central Budget Act of 1995 fixed a percentage share deriving from privatization.

2.5.2 *Property Previously Owned by Churches*

The rapid transfer of property previously owned by churches was a priority. Property previously owned by churches but state-owned in 1990 could not be transferred to local governments. Property confiscated from churches in 1948 had already been transferred to local governments.

Churches received only a part of the previously-owned property. Property were returned if they were used for religious activity, education, social welfare, healthcare or culture. Churches were required to file claims which were considered by the minister of culture. If a claim was approved, the minister called the property manager to make an agree-

ment with the church on the property transfer. If no agreement could be reached, a joint committee of church and government delegates arbitrated.

In some cases property previously owned by churches had already been transferred to local governments. In such cases the local government was forbidden to sell or borrow against the property until its status had been finalized. If local government property was transferred to churches, the local government received compensation. Property was to be returned within ten years.

Churches could make agreements directly with local governments, without central government involvement. In such cases, the minister of culture had to be informed on the final agreement.

2.6 Property Transfer Committees

2.6.1 *Regulation of Property Transfer Committees*

Section 107.3 of the Local Government Act authorized the government to establish property transfer committees in order to transfer:

- state-owned lands, forests, other real estate and waters determined by Property Transfer Act;
- all protected lands and monuments;
- public utility facilities;
- the assets of public enterprises.

Governmental decree 63 of 1990 on property transfer committees established these committees and determined their administrative structure and procedures.

Property transfer committees were formed of 13 members determined by the minister of the interior. In order to increase efficiency, three or more members could make decisions. In 1996, the government reduced the membership of the committees to 5.

Committees first informed local governments of the objects of property in question. A local government could declare its intention to take possession of a given property or agree to its transfer to another local government. Local governments would then establish work groups to assign values to the properties.

2.6.2 *Committee Functioning*

Significant differences in regulation and practice led to several problems. The committees were often not sufficiently prepared for the work they were assigned. They lacked back-

ground in administration. The legislature itself left room for errors, as well. A reliable and exact inventory of property was lacking. Local governments often were successors to councils which had no property of their own.

Although the government decree stated that local government employees should assist in the activity of the committee, this often did not happen. The decree stated that local government work groups should provide estimates, record properties and prepare for committee sessions. Local governments often did not have sufficient personnel with necessary expertise to complete tasks assigned to them. Local governments received no professional or financial assistance in the formation of work groups.

Property transfer committees were assisted by work groups consisting of civil servants of the local government, but the committees could not influence the work groups' activities. In theory, the committees had an administrative staff, but in practice the committee could not direct this staff. The civil servants who formed the work groups, meanwhile, had to fulfill their duties in addition to their functions in the government offices.

Preparation of the property transfer process was insufficient due to the failure of the land registry. The amount of cases which had to be registered with the office bogged down

the registry. As privatization was happening at the same time, the changes in ownership were rapid and often confusing. This was especially the case in the capital, due to the two-tier system of local government. Major problems occurred when two levels of government simultaneously took ownership of an object and it could not be recorded in the land registry in time.

2.7 Local Government Ownership

Local governments have the same ownership rights as any other entity, limited only by Section 80.3 of the Local Government Act, which states that any entrepreneurial activity must not endanger the discharge of their mandatory functions.

The exercise of ownership rights is determined by the representative body. By decree, a local government may designate certain objects to be sold, borrowed against or used for other purposes only if voters agree through referendum.

Through ownership status, local governments are encouraged to provide better and better services to the local populous, while entrepreneurial activity strengthens their independence.

ANNEX

Competencies of Local Governments

Table 2.A1
Competencies of Local Governments

Functions	All Municipalities (Alone or in Associations)	Regional/District or Urban Governments	Central or State Territorial Administration
EDUCATION			
1. Pre-school	✓		
2. Primary	✓		
3. Secondary		✓	
4. Technical		✓	
5. Other			
SOCIAL WELFARE			
1. Nurseries	✓		
2. Kindergartens	✓		
3. Welfare homes	✓		
4. Personal services for the elderly and handicapped		✓	
5. Special services (for the homeless, families in crisis, etc.)		✓	
6. Social housing		✓	
7. Other			
HEALTH SERVICES			
1. Primary health care	✓		
2. Health protection			
3. Hospitals		✓	
4. Public health			✓
CULTURE, LEISURE, SPORTS			
1. Theaters		✓	
2. Museums		✓	
3. Libraries		✓	
4. Parks	✓		
5. Sports, leisure		✓	
6. Cultural centers	✓		
7. Other			

Table 2.A1 (continued)
Competencies of Local Governments

Functions	All Municipalities (Alone or in Associations)	Regional/District or Urban Governments	Central or State Territorial Administration
PUBLIC UTILITIES			
1. Water supply	✓		
2. Sewage	✓		
3. Electricity			
4. Gas			
5. Central heating			
6. Other			
ENVIRONMENT, PUBLIC SANITATION			
1. Refuse collection	✓		
2. Refuse disposal	✓		
3. Street cleansing		✓	
4. Cemeteries	✓		
5. Environmental protection	✓		✓
6. Other			
TRAFFIC, TRANSPORT			
1. Roads	✓		✓
2. Public lighting	✓		
3. Public transport		✓	✓
4. Other			
URBAN DEVELOPMENT			
1. Town planning	✓		
2. Regional/spatial planning		✓	
3. Local economic development	✓	✓	
4. Tourism	✓		✓
5. Other			
GENERAL ADMINISTRATION			
1. Authoritative functions (licenses, etc.)	✓		✓
2. Other state administrative matters (electoral register, etc.)	✓		✓
3. Local police			✓
4. Fire brigades	✓		✓
5. Civil defense	✓		✓

COUNTRY REPORTS

Talis Linkaits

Transformation of State and Municipal Property in Latvia



FROM USAGE TO OWNERSHIP

Transfer of Public Property to Local Governments in Central Europe

Transformation of State and Municipal Property in Latvia

Talis Linkaits

1. LOCAL GOVERNMENT IN LATVIA

Article 101 of the Latvian *Satversme* (Constitution) stipulates that any Latvian citizen enjoys the right to elect local governments in compliance with the law. Despite complications related to administrative-territorial reform and municipal financing, local governments have developed into an effective political and administrative instrument.

1.1 Levels of Government

When Latvia regained its sovereignty in 1991, it inherited the administrative division of its territory as established in the Soviet period. This division was based on communist organizational principles; it was not intended to promote democracy. The territorial division of municipalities did not reflect the administrative-territorial structure developed over a longer historical period, but was based on the borders between collective farms and other Soviet-designed entities.

After regaining independence, city, town and *pagast* (parish) governments have expanded, and their independence and responsibility have increased. However, apart from minor changes, the administrative-territorial division of municipalities has remained as before.

1.1.1 Division of Municipalities in Latvia

The Law on Local Government, passed on May 19, 1994, established two levels of sub-national government in Latvia—local and regional.

Local government ensures the implementation of functions as determined by law, as well as tasks assigned by the Council of Ministers and voluntary initiatives of municipalities aided by its council—an elected body representing citizens—and institutions established by it, taking into account the interests of the state and the inhabitants the respective administrative-territorial unit.

Regional government, aided by a council—a representative body delegated by local authorities—ensures the im-

plementation of functions determined by law, as well as those functions delegated by local governments and institutions established by it, taking into account the interests of the state and the inhabitants of the administrative territory of the respective region.

The Law on Administrative-Territorial Reform passed on October 21, 1998 called for the formation of *novadi* (districts) and *apriņķi* (regions)—municipalities of a larger scale to be established through administrative-territorial reform. A *novads* is an administrative-territorial unit established as a result of uniting parishes and cities under a single local government. An *apriņķis* (a region) is an administrative-territorial unit consisting of districts, towns and parishes, and cities, except for Riga—the capital city of Latvia. Upon completion of administrative-territorial reform, the following administrative territories will exist in Latvia: *apriņķis*, *novads*, *pagasts*, towns and cities, and the capital city of Riga. The planned deadline for the implementation of the administrative-territorial reform is November 30, 2004.

Activities of municipalities are supervised by the municipal affairs authority, a body authorized by the Council of Ministers, a public civil institution subject to the minister for special assignments in state reforms implementing the tasks stipulated by regulatory documents on municipal issues, developing strategy for municipality development and organizing the implementation of the municipal reform.

The governmental institutions and officials supervising the legality of the activities of the municipalities according as stipulated by law must report any breaches of the constitution or the law to the municipal affairs authority. Municipal operations and their financing are monitored by the state audit office.

1.1.2 Representative Bodies

The representative bodies of cities, towns and regions are councils called *dome*. Parish councils are called *padome*. The number of councilors ranges from seven to fifteen (with sixty for the City of Riga). Council-members are elected through universal suffrage. Regional councils are not elected directly,

but formed of delegated representatives of local governments. Councils have no distinct executive body.

1.1.3 Heads of Local and Regional Government

The chairperson of a council is the political head of the local government. He/she is elected by the councilors of the respective council by secret vote.

The chairperson of a city or parish council has the following duties:

- Conduct the work of the council and coordinate the review of committee activity.
- Represent the council in relations with state and other local authorities.
- Represent the council in court without any special authorization.
- Issue proxies, sign agreements and other legal documents on behalf of the council.
- Conduct the work of the financial committee.
- Issue binding directions for council staff.
- Propose a review of issues by the council and in committees.
- Prepare for review of applications submitted by state institutions and officials.
- Bear personal responsibility for the execution of court decisions in cases where the council is one of the parties.
- Present proposals on the dismissal of officials of state institutions located in the administrative territory of the local government.
- Fulfill other duties delegated by law or according to regulations of the respective local government and decisions of the council.

The political head of the local/regional government does not receive direct tasks from the government.

1.1.4 Chiefs of Administration

The chief of local administration is the executive director. He/she is appointed by the council upon proposal by the chairperson. The executive director of the local government has the following duties:

- Organize the implementation of binding regulations and other regulatory documents issued by the council.
- Give orders to the heads of local government institutions.
- Prepare proposals to the council concerning the cancellation of illegal decisions by local institutions.
- Suggest to the council the appointment or dismissal of the heads of local government institutions and enterprises.

- Submit proposals to the council concerning the establishment, reorganization and dissolution of local government institutions and enterprises.
- Manage municipal property and financial resources; conclude business transactions with legal entities and individual persons in accordance with the procedure and framework determined by the council.
- Organize the establishment of the socio-economic development plan, the general regional planning of the territory and the draft budget of the respective municipality.
- Perform other duties stipulated by the regulation of the respective local government and decisions of the council.

1.1.5 Powers and Responsibilities

The permanent functions of municipalities are as follows:

- Organize municipal services for residents (water supply and sewage networks, heating, collection, disposal, storage or processing of household waste, collection, disposal and purification of sewage).
- Provide maintenance and sanitation in its administrative territory (construction, reconstruction and maintenance of roads and squares; provision of lighting in streets, squares and other public territories; supervision of the collection and disposal of industrial waste, anti-flood measures, formation and maintenance of cemeteries and places for burial of dead animals).
- Determine procedures for the use of public forests and waters unless otherwise provided by law.
- Provide for residents' education (securing rights to primary and general secondary education).
- Support culture and promote traditional cultural values and the development of creative activities (organizational and financial assistance to cultural institutions and activities).
- Secure access to health care.
- Ensure social assistance for needy families, the elderly, the homeless and other socially vulnerable persons.
- Administrate over adoption, trusteeship and guardianship issues.
- Render housing support to residents.
- Promote entrepreneurial activity to prevent unemployment.
- Issue permits and licenses on entrepreneurial activity as stipulated by law.
- Ensure public order; fight heavy drinking and profligacy.
- Supervise urban planning in accordance with the development plan of the respective administrative-territorial unit.

- Register public records.
 - Collect information necessary for national statistics.
 - Organize elections.
 - Participate in implementing civil defense measures.
 - Organize public transport services.
 - Ensure the representation of local authorities in regional health insurance institutions.
 - Organize the development of teacher training and the methodology of educational activities.
- The last three functions shall only be performed by cities' self-government bodies. The legal basis of the internal structures of local/regional authorities is regulated by the council.

Statistical data

The Republic of Latvia covers a territory of 64,589 sq. km and has a population of 2,351,000. The population density is 36.4 persons per sq. km.¹

There are 26 regions and 548 municipalities altogether: seven cities, 62 towns, 10 districts, 469 parishes and 26 regional governments.²

Smallest towns by population:	Durbe (Liepaja region)	465 inhabitants
	Subate (Daugavpils region)	1,013 inhabitants
	Piltene (Ventspils region)	1,217 inhabitants
Smallest parishes by population:	Kalnecmpji (Alūksne region)	392 inhabitants
	Jūrkalne (Ventspils region)	394 inhabitants
	Lazdulejas (Balvu region)	396 inhabitants
	Zvarde (Saldus region)	400 inhabitants
	Ipiki (Valmieras region)	397 inhabitants
Largest parishes:	Dundaga (Talsu region)	559 sq. km
	Ance (Ventspils region)	392 sq. km
	Targale (Ventspils region)	365 sq. km ³

Breakdown of Latvian municipalities by the number of inhabitants

In 71% of the municipalities, the number of inhabitants is below 2000, but the total number of inhabitants living in these municipalities accounts for only 15% of the total population in Latvia. In such a situation, the financial resources are scattered among the many small municipalities thus resulting in an even more inefficient use of the scarce resources. In 2000, the amount of the mutual settlement of accounts between municipalities reached 5.9 million lats⁴.

Due to their small scale, many municipalities have little revenue of their own. For instance, in 1999 the budget revenues of 33 municipalities, apart from special purpose subsidies, did not exceed 50 thousand lats. A small municipality is not capable of concentrating financial resources. The municipalities where, apart from the special purpose subsidies, the yearly revenue does not exceed 100 thousand lats have problems attracting investment, and there are more than 200 such municipalities in the country. Municipal revenues per inhabitant differ by 1000, even 2000%.

Breakdown of municipalities by municipal revenues

In small municipalities, administrative expenses per inhabitant exceed expenses the larger municipalities. For instance, among rural municipalities with more than 10 thousand inhabitants, the expenses of local authorities are 13.3 lats per inhabitant, whereas in the group of local authorities where the number of inhabitants is less than 700, administrative expenses of municipalities amount to 24.7 lats per inhabitant. In 1999, there were 24 municipalities in this country, where the expenses of the executive and legislative authorities exceeded the tax revenue of the respective municipality.

Usually, the administrative territories with a small number of inhabitants do not have adequate infrastructure for the implementation of the functions assigned to municipalities. 86% of municipalities have not developed and legally accepted development plans for their territories. This factor prevents the attraction of investment, restructuring of their operations and creation of new jobs. The situation with respect to municipalities is specific in Latvia, as half of the population (50%) has only one local government, while the other half has both local and the regional government.

2. DEVOLUTION OF PUBLIC PROPERTY IN LATVIA

2.1 Types of Property

2.2.1 *Land, Forests and Water Resources*

2.2.1.1 Land

Municipalities may own land. The law⁵ stipulates that during land reform (see Section 4 on the background of land reform), the following categories of land shall be entered in the land registry in the name of a municipality:

- 1) Land owned by a municipality as of July 21, 1940,⁶ in its current administrative territory and woodlands (even if in other administrative territories), except:
 - land transferred to individual persons or legal entities as compensation for previously-owned land;
 - land assigned to individual persons for permanent use or reserved with the right to ownership;
 - land where state-owned buildings, enterprises, state-owned property being privatized are located.
- 2) Land owned by individual persons or legal entities as of July 21, 1940, if the above persons or entities have received compensation for the land, have not claimed the restitution of their ownership rights to the land, or the restitution of ownership rights to the land has not been stipulated by law, in the following cases only:
 - if buildings and constructions owned by a municipality are located on this land;
 - if in view of applications submitted by local authorities during land reform, the respective land plots have been allocated as building sites for new buildings, as well as for the implementation of the functions of local governments in the approved plan of a parish or city or the land utilization plan (if such plans have not been drafted or approved yet, the necessity and scale shall be arbitrated by the ministry of finance and the ministry of environmental protection and regional development);
 - if there are residential houses on this land containing privatized apartments.
- 3) Land owned by the state as of July 21, 1940, if the following facilities are located on this land:
 - buildings housing companies owned by a municipality;
 - privatized objects of municipal property or buildings owned by a municipality or municipal companies;

- apartment houses in which apartments have been privatized.
- 4) Land where streets have been built using state or municipal funding and owned by the municipality.
 - 5) Land located in the current administrative territory of municipalities and owned by the rural municipalities as of July 21, 1940, except:
 - land transferred to the ownership of an individual or legal entity as compensation during land reform;
 - land transferred to an individual person for permanent use or reserved with the right of ownership;
 - land containing state-owned buildings, state-owned enterprises or privatized state-owned property.

After land reform is completed, the state is entitled to enter ownerless land in the land registry in the name of the state.

The state may engage in transactions with land according to the laws regulating the privatization of state-owned and municipal land, as well as general transactions with the land owned by the state and municipalities. These laws limit the range of land purchasers, but do not stipulate any special regulations for land sale or transfer that differ from those applicable to the state.

Types of Land Privatization

There are three types of land privatization:

- 1) Restitution of land ownership rights to former landowners or their heirs—there is a general procedure for this (found in the Law on Land Privatization in Rural Areas and the Law on Land Reform in Cities and Towns) and certain special procedures (ownership rights for religious organizations, for example, were restored under a special law).
- 2) Transfer of ownership rights to land through payment.
- 3) Privatization of land to which the state or a municipality is entitled.⁷

1) *Restitution of Land Ownership Rights to Former Landowners or Their Heirs*⁸

Pursuant to the Civil Code, those who owned land on July 21, 1940 or their heirs could recover their land ownership rights on the basis of a personal application (complying with deadlines and restrictions as stipulated by law).

The previous owners received ownership rights to their land, ownership rights to land of equal value within the parish or region or compensation in equal forms.

2) *Transfer of Ownership Rights to Land through Payment*

Ownership rights to land through payment may be transferred to persons to whom it has been allocated for permanent use, if they are performing the duties of land users as stipulated by law and if the ownership rights to this land have not been restored to its former owners or their heirs.

The total area of transferred land may not exceed 150 hectares, 50 hectares in woodland areas. Issues on allocating larger area of land and woodland are decided by the Central Land Commission on the basis of the recommendation of the land commission of the respective parish.

The government stipulates a uniform procedure for calculating and making payments.

Municipalities and their institutions compile and review applications for land privatization and make decisions according to the procedure stipulated by law.⁹

*Land Transactions*¹⁰

Transactions may be conducted only with land whose owners are entered in the land registry. Any transactions resulting in a change of ownership, as well as testamentary inheritance, sale or transfer of pledged land or investment of land as a share capital of a company, are deemed land transactions.

In Latvia, land may be acquired by:

- 1) Latvian citizens;
- 2) the state and its municipalities or publicly-owned companies;
- 3) religious organizations, if they have been operating in Latvia for at least three years since the moment of their registration;
- 4) a company listed in the enterprise registry, on the following conditions:
 - a) More than half of its capital is owned or jointly owned by Latvian citizens, the state or municipalities, jointly or severally.
 - b) More than half of its capital is owned or jointly owned by individual persons or legal entities from countries with whom Latvia has concluded international agreements on investment promotion and protection before December 31, 1996; or to individual persons or legal entities from countries with whom Latvia has concluded international agreements after December 31, 1996, if the agreements provide for the rights of individual persons and legal entities registered in Latvia to acquire land in the respective country.

- c) It is a public joint stock company and its shares are listed on the stock exchange.

Other individual persons or legal entities may acquire land subject to restrictions stipulated by law. They cannot acquire the following:

- land in areas near state borders;
- land in the protected sand dunes along the Baltic Sea and Riga Gulf, in protected public waters, unless sited for construction in the parish development plan;
- land in state reserves;
- agricultural and forest land in the parish development plan.

Should other persons or entities as described above wish to acquire land, they must submit an application to the local government indicating plans for use. A deed must be included with the application, except for in cases where government institutions privatize land for the state's use.

These applications are reviewed by the chairman of the local government council. If the proposed use does not contradict the parish plan, in compliance with the regulations on territorial planning issued by the Council of Ministers, and if in compliance with legal ownership restrictions, the chairman may approve the application within 20 days.

If the parish plan has not been approved or taken legislative effect, the chairman must consult with the ministry of environmental protection and regional development. The ministry has two weeks to make a decision. A deed of transaction will only be considered valid if this ministerial approval is enclosed with it. The parish government sends these documents to the state land service. If an application is not approved, interested parties have the right to appeal.

Former landowners or their heirs, who claimed land before June 21, 1991 and who have been registered in a special register of unsatisfied claims, retain the right of first refusal over the land to which their ownership rights were not restored.

3) *Municipal Land Privatization Procedures*¹¹

A special procedure is stipulated for the privatization of land containing state-owned or municipal property (companies or their structural units) designated for privatization, land containing already privatized state-owned or municipal property and state-owned or municipal land without any buildings or structures.

A municipality implements privatization of land containing municipal property designated for privatization or already privatized. However, if the land contains privatized state-owned property, privatization is implemented by governmental institutions.

The new owners of privatized property retain the right of first refusal over land owned by the state or municipalities on which their respective objects are located.

If the entity who holds the right of first refusal does not exercise it, the entity has lease rights, and the plot must not be confiscated.

Land must be sold for a price not less than the cadastral value of the land, determined in compliance with the Council of Ministers' regulations on land valuation. The institution performing privatization determines the price of a particular plot. Payment for privatized land shall be transferred to the privatization funds of the state-owned or municipal property.

2.2.1.2 Woodlands and Forests

The woods growing on a piece of land are the property of the landowner and must be privatized along with it.¹²

Approximately 50% of woodland in Latvia is owned by the state; the remainder being private property of individual persons or legal entities, which acquired the land during land reform. Municipalities are considered private owners who must comply with provisions of special laws regarding the use of woods.

The use of private woods is restricted by regulations on forest protection and hunting,¹³ as well as other special laws.

The state land service supervises the use of all woods and forests in Latvia. It is responsible for the implementation of a uniform wood policy in all woods, supervises the compliance with regulatory documents and implements support programs to ensure sustainable forestry. The state joint stock company *Latvijas Valsts Meži* (Latvian State Woods) manages and maintains state-owned woods and performs the functions of the owner.

The Forestry Law stipulates that forests are an ecosystem in all stages of development, dominated by trees at least seven meters in height, with a current or prospective foliage projection of at least 20%. Woodlands are lands containing forests, objects of wood infrastructure, as well as occasionally flooded open spaces, bogs and glades, located in or adjoining a forest.

Any person enjoys the right to stay and freely move in state-owned or municipal forests. In other woods, these rights may be restricted by the owner or lawful possessor.

A municipality, following a proposal from the state land service or an institution of environmental protection, in the interest of fire safety or the protection of wild plants and animals, may restrict the rights of individual persons to stay and freely move in the woodlands.

If the rights of an individual person to stay and freely move are restricted, it is the duty of the owner or lawful possessor to mark affected territory with clearly visible signage.

Woodland owner (including municipalities) must obtain a permit from the state land service for the following activities: 1) logging, 2) building or reconstruction of objects which may affect the forests, 3) the building of roads for forestry, 4) the procurement of reproductive material from the wood, 5) the use of mineral fertilizers and pesticides.

A municipality may conduct transactions with and confiscate woodlands according to the same terms and conditions as land transactions.

2.2.1.3 Waters

Latvia contains public and private waters. Public waters are those along the seacoast as well as the lakes and rivers listed as public in the annex to the Civil Code.¹⁴ The list of public waters may be amended by legislative process only. Losses thus incurred by the owner shall be compensated by the state.¹⁵

Public waters are the property of the state—they are not subject to sale or transfer. Private waters are all other waters owned by individual persons or legal entities, including municipalities. Water legislation applies to both surface and subterranean waters.

Ownership rights to a river comprise:

- 1) ownership rights to the riverbed;
- 2) rights to use the river itself – fishing rights, the right to use water power, etc.

Private waters, which extend across or adjoin land plots of several owners, are in the jointly owned. Underground waters deemed mineral resources of national importance are owned by the landowner.

During land reform in rural areas, both individual persons and legal entities entitled to claim land, could also claim waters (rivers, lakes, water reservoirs, canals, etc.) as well as the land they occupy. Rights of land usage were documented simultaneously with rights of water usage.¹⁶

Except for public waters, surface waters are to be privatized along with the land in which they are contained.¹⁷

Water transactions

Water transactions follow general procedures similar to those governing land transactions.

Any person is permitted the everyday use of public rivers, insofar as this does not harm the public or infringe on the rights of landowners.¹⁸ Any individual person or legal entity may lease public waters, as regulated by the Council of Ministers.

Public waters are leased on behalf of the state by:

- 1) The fishery authority of the ministry of agriculture, if the body of water is leased for fishery purposes (subject to prior agreement with the local government and the regional environmental authority).
- 2) The local government in all other cases. Should the body of water be contained in territories of several municipalities, they must mutually agree on leasing procedures.

Public water bodies are leased for the purposes of industrial fishing, fishing as a hobby—angling, or fish farming.

After an agreement with the fishery authority and regional environmental authorities of the ministry of environmental protection and regional development, waters are leased for the following uses as well:

- 1) protection of objects of cultural and natural heritage;
- 2) procurement of drinking water and procurement of water for special purposes;
- 3) scientific research;
- 4) recreation and water sports;
- 5) water power;
- 6) transport;
- 7) mining of peat and mineral resources;
- 8) construction and maintenance of hydrotechnical structures.

If the body of water is intended for industrial fishing, a special lease agreement on the rights of industrial fishing is concluded in addition to the lease agreement. The transfer of usage rights and industrial fishing rights to other individual persons or legal entities is forbidden.

After an agreement with the fishery authority, the supervision of fish resources and the lease of the industrial fishing rights may be delegated to municipalities.¹⁹

The conditions related to the principle of free access must be included in the lease agreement and the regulations of use and maintenance of the body water.

The lessee of the public water body has no right to charge fees for the above uses of public waters. The lessee may charge for additional services to ensure. Charged services must be stipulated in the lease agreement.

Charges for the lease of bodies of water must be calculated on the basis of the surface, its use and other socioeconomic factors.²⁰ If the water body and the industrial fishing rights are leased simultaneously, the lease payment is divided into a payment for the water body lease and payment for the industrial fishing rights respectively.

Resources from the total amount charged for the lease of the industrial fishing rights or their auction, and the use of the rights of industrial fishing are distributed as follows:

- 70% of the total must be transferred to account of the fishery authority.
- If the lease payment has been made to a municipality, 30% of the total must be transferred to a special municipal account for the organization and management of fishing.
- 30% of the total amount collected by the fishery authority or the institutions of the ministry of environmental protection and regional development must be transferred to the account of the above institutions.

Use of water is divided into:

- 1) the general use of water, for which no permit is required;
- 2) the special use of water, for which a permit is required—the procedure for its issuance is regulated by the Council of Ministers.

The special use of water means²¹ activities affecting the quantitative or qualitative indicators of both surface and underground waters, in any of the following conditions:

- 1) The amount of sewage waters in a particular place of their outflow exceeds 5 m³ in 24 hours.
- 2) Extraction of underground waters exceeds 10 m³ in 24 hours.
- 3) Mineral waters are extracted for reasons other than personal use.
- 4) The hydro-regime of a body of surface water body is affected, or surface water consumption exceeds 20 m³ in 24 hours.
- 5) The above amounts are not exceeded but a material impact on the environment could occur due to water extraction or emission.

In this respect any individual person or legal entity that extracts waters or uses them in their business operations may be a water user. A permit for the use of water certifies the right to use water and stipulates the types of uses, amounts, timelines, as well as duties of the water user regarding water protection.

The person or entity requesting a permit must submit an application to the regional environmental authority, filled in and approved by the local authorities, for receiving a per-

mit for the use of water. The municipality has the right to request the cancellation of the permit or to require amendments to it.

2.2.2 Mineral Wealth

Before Latvia regained its independence, mineral wealth was owned by the state. In 1992, the Civil Code of 1937 was reenacted, including the provision that the riches of the earth and all mineral resources thereof are owned by the landowner. Despite public discussions, the same provision was retained in the Law on Mineral Wealth, passed in 1996.

Mineral wealth is the possession of the landowner.²² Any person eligible to acquire land may become the owner of riches included therein.

Principles of mineral wealth:

- 1) Mineral wealth shall be used for the benefit of the landowner, the state and the public simultaneously.
- 2) Mineral wealth shall not be included in the cadastral value of the land, and no property tax shall be levied on it.
- 3) Landowners and individual persons to whom land has been transferred for permanent use may extract encountered mineral resources without a permit and free of charge only for personal use.
- 4) Activity must be in compliance with the regulations for the preservation of protected territories, objects and cultural heritage.
- 5) In order to ensure the efficient use and preservation of mineral wealth, the state and municipalities have the right to suspend, limit or terminate the use of minerals according to the procedure stipulated by law.

The law²³ stipulates the following users of mineral wealth: 1) landowners, 2) a person to whom the land has been allocated for permanent use, 3) a legal entity or individual person, as well as a foreigner or a foreign legal entity, who has concluded an agreement with the landowner.

Supervision of the Use of Mineral Wealth

Regardless of the ownership of mineral wealth, the following authorities supervise its use on behalf of the state:

- 1) the ministry of environmental protection and regional development and the state geological service (an institution reporting to the ministry that ensures efficient use of the riches of the earth and the state geological supervision of the riches of the earth);
- 2) the ministry of the economy;
- 3) local governments of parishes and cities.

The ministry of the economy organizes issues permits and supervises hydrocarbon research and extraction.

The roles of local governments are outlined below:

- 1) According to the procedure stipulated by the Council of Ministers and in the amounts determined by the ministry of environmental protection and regional development, local governments issue permits for the use of frequently encountered mineral resources (clay, sand, grit, peat) within yearly quotas and limits. If a mineral deposit is located in the administrative territory of several parishes and cities, permits are issued by the state geological service.
- 2) Local governments control the recultivation of mineral deposits.

The expenses incurred as a result of the implementation of the functions delegated to municipalities are covered by the payments received for permits. The Council of Ministers stipulates the amount and procedure of payment.

Permits for the use of the riches of the earth are issued to the local governments free of charge with respect to the land owned by them or the state-owned or municipal lands transferred to them for permanent use. If mineral resources are intended for the maintenance of roads, territorial improvement, or maintenance to buildings owned by the respective municipalities, permits are issued on the basis of application by municipalities and in compliance with the stipulated amounts of extraction.

It is forbidden to sell, give away, pledge or exchange a permit. In the event the users of the mineral wealth change, the previous permit loses effect, and the new user must obtain a new permit.

For state-owned or municipal land areas, permits are issued by tender or auction. Any legal entity or individual person, as well as foreign legal entities and individual persons may participate.

Landowners (except the state and municipalities) issue permits for the use of the mineral wealth on their property. This procedure does not apply to mineral resources of national importance (hydrocarbon, crude oil, natural gas, underground waters) and their deposits, as well as land areas of national importance. Landowners may transfer their rights to other legal entities or individual persons by concluding an agreement—a prerequisite for receiving a permit for the use of mineral wealth.

The general tender, auction and licensing procedure is controlled by the Council of Ministers.

2.2.3 Utility Companies

Municipalities may own public utility companies, which provide services in line with municipal functions. Municipal enterprises and companies provide water and sewage services, central heating and street lighting. Power supply, gas and telecommunications companies were established as state-owned enterprises and have been gradually privatized. Because of the country's small size, establishing municipal enterprises for such services was deemed economically ineffective.

There are no special terms and conditions stipulated by law for the privatization of public utility companies, they may be confiscated like other business enterprises.

So far, none of the significant municipal public utility companies have been privatized. *Liepājas siltums* (Liepāja Heat), the heating company owned by the city of Liepāja, was the first energy monopoly that went insolvent in 1997. Poor management and inadequate tariffs caused the insolvency. Through the insolvency procedure, the company has been restructured and its debts sold. In 2001, the creditors approved an investment program of 8.3 million lats. It is scheduled to regain solvency in 2003, with more than 75% of the capital to be sold to private investors.

2.2.4 Other Companies, Enterprises and Commercial Assets

Municipalities may own business enterprises, shares in private companies or enterprises with state capital. A municipality decides on the decrease or increase of its participation in such companies subject to their performance.

Pursuant to the law, privatization is a mix of activities which result in changes of ownership of municipal enterprises, companies, real estate or equity shares owned by a municipality—from ownership by a municipality to ownership by individual persons or legal entities—where the share owned by the state or municipality is less than 75% and which is not the state or a municipality, or a state-owned or municipal enterprise.²⁴

Different laws regulate the privatization of different properties. The privatization of enterprises, companies, equity shares and also real estate and land is regulated by the Law on Privatization of State-Owned and Municipal Property; privatization of apartments by the Law on Privatization of State-Owned and Municipal Residences. Alienation of real estate, which in principle could be considered privatization, is regulated by the Law on Alienation of State-Owned and Municipal Assets.

Besides, special laws regulate various details of the privatization process. For instance, the Law on Transformation of State-Owned and Municipal Enterprises stipulates the procedures for transformation and privatization of municipal enterprises; the Law on Privatization Commissions of State-Owned and Municipal Property provides the procedures for the establishment and activities of a privatization commission on municipal property; the Law on Privatization Funds of State-Owned and Municipal Property stipulates the procedures for use of resources generated by privatization. On the basis of laws issued by the Council of Ministers, a number of regulations control different methods of privatization and specific issues of the privatization process; they are also binding on municipalities.

The current law controlling the privatization of municipal property is based on the principles stipulated by 1992 Law on Privatization Procedures for State-Owned and Municipal Property (hereinafter, the Old Privatization Law).

Privatization is being implemented “from bottom to top,”²⁵ i.e., any individual person or legal entity may initiate the privatization of an object.²⁶ It is the municipality's task to compile the received proposals and make a decision on the designation of particular objects for privatization. The role of the municipality in the commencement of privatization is proactive—the legislative body has not literally given municipalities the right to initiate the privatization of its own property and make a respective decision. However, such interpretation of the law limits the rights of municipalities. Interpreting this provision in a logical and broader sense, any individual person and legal entity may initiate the privatization of an object, including the owner of the object (who in the sphere of private law is also a legal entity), should have such rights.

However, this is not the only condition of municipal passivity which to survive the Old Privatization Law. Before October 24, 1996, when amendments were made to the law, it did not provide the municipality an opportunity to determine the general principles of privatization. Now, when making a decision on the designation of an object for privatization, the municipality is entitled to stipulate the basic principles of privatization.

After an object has been designated for privatization, the entity or person enjoying the right of first refusal may apply within one month; within two months, creditors of the enterprises or companies to be privatized may submit their claims.

The subjects enjoying the right of first refusal are as follows:²⁷

- 1) the owner of the land plot where the object is located (if the area of this land plot is more than half of the territory occupied by the object);

- 2) the lessee of the object, if the lease is for more than a year, the lease agreement is registered according to the procedure stipulated by law, and the lessee has no lease debts;
- 3) a co-owner of the object, if the municipality intends to sell part of their joint property.

The entities retaining the right of first refusal have several advantages over other candidates. These advantages differ also from the mechanism of exercising the right of first refusal as stipulated by the Civil Code. First, it is not compulsory for the entities retaining the right of first refusal to submit a privatization plan for the object. The second and most important benefit is the right to purchase the object for the initial or value-based price (instead of an auction price as would be the case if the Civil Code were applied). Thirdly, if the landowner exercises the right of first refusal, he may choose to pay the entire purchase price in privatization vouchers.²⁸

Within the terms stipulated by the municipality and at least two weeks after the announcement has been published in the official newspaper, any individual person or legal entity may submit a privatization plan for the object to be privatized. No later than a month after the deadline, the municipal council reviews the submissions and may decide between the following options:

- 1) to approve one of the submitted privatization plans;
- 2) to reject all submissions and set forth a new term for the submission of plans;
- 3) identify the fact that no privatization plans have been submitted and a) set forth a new term for the submission of plans or b) ask the privatization commission to draft a privatization plan of its own.

A privatization plan consists of a description of the object to be privatized, privatization conditions and the sequence of privatization measures. It must be approved by the municipality. In essence, the municipality, as the owner, should be entitled to stipulate the conditions of sale; however, the law is designed on the principle of privatization ‘from the bottom.’ This manifests itself in the process of drafting the privatization plan as well: initially, the municipality itself may not draft the plan; it must review all submitted plans, approve one or reject them all, and only in that case may the municipal privatization commission draft a privatization plan reflecting the interests of the municipality.

On the other hand, in order to prepare for the privatization of the object qualitatively and develop a well-considered privatization plan, the prospective bidder would need comprehensive information about the object to be privatized and the possibility to visit it. The law, however, is not explicit enough to prevent officials from refusing access to

important information related to the operations of the object. Article 38 of the law states that: “any entity interested in an object to be privatized has the right to be acquainted with information regarding the structure of assets and liabilities, business operations, as well as the status of its property according to the procedure and in the amount stipulated by the municipality.”

The municipality may approve a conditional privatization plan. If these conditions are not fulfilled within the term set forth by the municipality, the approval of the plan becomes invalid.²⁹

After the approval of a privatization plan, the object’s alienation process may begin. Within a week after the approval, the municipality offers the object for sale to the subjects entitled to the right of first refusal, under the terms and conditions contained in the privatization plan. If the subject entitled to the right of first refusal fails to give a positive answer within two weeks, his right of first refusal expires.³⁰

If the person entitled to the right of first refusal has not exercised its right, the municipality may commence the activities described by the privatization plan: announcement of its auction, establishment of a private company, conclusion of the purchase agreement, etc. Prior to the privatization or conclusion of the purchase agreement, it is imperative that the prospective bidder confirm solvency, freedom from tax debts or debts against the object to be privatized.³¹

The ministry of the economy has a restrictive role in the privatization of municipal property. Within ten days, the ministry must be notified of the establishment of the municipal privatization commission, changes to it or its liquidation.³² The ministry of the economy reviews disputes on the composition of the commission.

Within two weeks after the approval of the privatization plan, the approved plan together with duplicates of the documents certifying the legality of the actions of the municipality during the object’s privatization and reflecting the facts mentioned in the privatization plan must be submitted to the ministry.³³

Within a month after the receipt of the documents from the municipality, the ministry approves of the privatization plan or, on discovery of failure to comply with the requirements of the process, suspends the municipality’s decision.

The ministry of economy’s rights generate additional risks to the participants in the privatization transaction, particularly to the person entitled to the right of first refusal, who might have already concluded a purchase agreement, had it not been necessary to wait for the ministry’s approval. There have been cases when municipalities fail to submit a privatization plan to the ministry of the economy within the two weeks stipulated by law, whereas the ministry may make its decision within a month after all required documents have been received. The considerable amount of work at the min-

istry of the economy should also be taken into account: in 2001, the ministry reviewed 494 privatization plans.³⁴

Resources from the privatization of municipal property are not transferred to the budget of a municipality, they are accrued in a special non-budget fund—the Municipal Property Privatization Fund—and the council of the respective municipality must approve the planned program for its use and the actual use of its funds. Although the purpose of establishing such a fund was the allocation of income from privatization for entrepreneurial development within the territory of the municipality, the municipality may deal with these resources at its own discretion and allocate them to serve any acute needs.

2.3 Scale of Municipal Property by Major Groups

According to the information of the state land service, compiled at the beginning of 2002, municipalities own 23,176 plots of land covering a total area of 90,999.2 hectares. 58,220 plots covering a total area of 293,273.3 hectares had been transferred to municipalities at the beginning of 2002. The overall number of plots transferred to municipalities forms 13.5% of the country's land properties. Whereas the total area of the real properties transferred to municipalities accounts for only 5.9% or 384,272.5 hectares of the owned land in the country.

Table 3.1
Land Breakdown by Target Groups of Real Estate Use
(as of the beginning of 2002)

Purpose of Real Estate Use	Number of Properties Owned by Municipalities	Area [ha]	Number of Cases Where Municipalities Use the Land	Area [ha]	Total Number of Properties in the Country	Area [ha]
Agriculture	830	782.7	1,672	15,382.4	28,943	45,896.9
Forestry	342	6,546.2	233	4,552.1	1,658	21,935.1
Water supply	18	120.9	844	1,655.3	149	12,713.3
Mining and quarrying	41	134.5	383	582.6	621	1,608.2
Fishing industry	3	8.2	2	60	400	493
Residential houses	298	133	336	2,423	19,741	3,697.3
Apartment houses	1,400	552.9	563	350.3	3,228	1,277.4
Office buildings	111	141.4	554	282.8	871	383.2
Administration, health care, education, culture, sports and other social facilities	226	514.9	835	2,094.2	1,613	4,471.5
Industrial facilities	835	167.2	174	144.9	981	1,713.1
Traffic infrastructure facilities	377	737.5	1809	4,088.6	2,691	10,170.3
Networks and facilities of public utilities	141	201.6	874	192.6	363	653.1
National defense facilities	4	3.2			181	959.7
Sea harbors and terminals	28	109.2	5	18.1	193	835.9
Other objects	22	145.8	236	127.1	333	257.2
Total	2,376	9,099.2	5,820	2,973.3	60,366	6,458,865.2

Table 3.2
Municipal Revenues from Privatization and Sale of Real Estate and Land
[In Thousands of Lats]

Revenue Breakdown	1998	1999	2000	2001	2002 (first half)	2002 (estimate)
Revenue from the sale of municipal real estate	340	527	592	657	676	588
Revenue from the sale of land	56	82	180	174	89	416
Revenue from privatization	6,165	8,768	15,522	11,526	3,932	10,969

Municipalities own more apartment houses than any other kind of property, while forestry properties cover the largest area. Among properties used by municipalities, the greatest number is in traffic infrastructure facilities, while agriculture is the largest group by area.

At the beginning of 2002, municipalities owned equity shares in 1,073 enterprises and companies (in various amounts up to 100%). Such enterprises and companies account for 0.83% of the total number of enterprises and companies registered in Latvia. By the beginning of 2002, 165,946 enterprises and companies had been registered, and 129,304 were active (i.e., they had not been liquidated).

Income from privatization accounts for the greatest share of non-tax revenues in the municipal budgets. According to Table 3.2, municipal revenue from privatization has tended to increase each year. However, in 2001 and 2002, the revenue decreased due to the completion of most large-scale privatization.

Municipalities have increased the amount of real estate sold each year, from 340,000 lats in 1998 to 657,000 lats in 2001. In the first half of 2002, the amount of the real estate sold already exceeded the estimate for the whole of 2002.

The sale of land has proceeded on a smaller scale, but land sales have tended to increase as well, reaching 174,000 lats in 2001.

In general, municipal revenues from privatization and sale of real estate and land form only a small part of the budget; only 2%, for example, in 2002.

2.4 Transfer of State-owned Property to Municipalities

Its territory, property and finances form the economic base of each municipality. Article 76 of the Law on Local Government stipulates that the economic basis for a local government is its property and assets as well as financial resources. Municipal property is distinct from state-owned property, and a municipality may dispose of it independently, in com-

pliance with procedures stipulated by law.

One of the first conceptual documents passed by the Latvian Parliament on independence was a decision on the basic principles for the conversion of state-owned property, part of the larger transition of the economy. Municipal ownership grew out of this movement.

The declaration of March 20, 1991 stated that all property not owned by individual persons, cooperative organizations or nongovernmental organizations was the property of the state. This nationalization was the first step in restitution, privatization and the creation of local government.

Parliament also stipulated that transfer of state-owned property to municipalities shall be without compensation and subject to request from municipalities, with the final decision made by the Council of Ministers.

The principle that a municipality must have its own property has never been disputed in Latvia. Already on September 26, 1990, one of the first parliamentary laws (the Law on Entrepreneurship) contained the principle that a municipality may conduct business activities to the same extent and by the same resources as other subjects of law (individual persons, the state, nongovernmental organizations, religious organizations, legal entities established by the above). The law stipulated that all entrepreneurs have equal rights in their operations.

Individual persons, legal entities, the state and municipalities have the right to freely choose forms of entrepreneurship. Municipalities have the right to establish municipal enterprises, limited liability companies and joint stock companies 100% owned by the municipality, as well as to participate in the establishment of companies with mixed public and private equity. A special law regulates each form of entrepreneurship in more detail. The Law on Municipal Enterprise, passed in March 1991, regulates the procedures for founding, operating, reorganizing and liquidating a municipal enterprise. It stipulates that a municipal enterprise is an independent business unit with the status of a legal entity, which conducts business for the benefit of the economic and social development of the respective territory. The mu-

municipal enterprise is liable for all its assets, whereas the municipality is liable for the enterprise.

On the basis of the parliamentary decision on the conversion of state-owned property, the Council of Ministers passed decision 171 on July 1, 1991, which regulated the large-scale transfer of state-owned property to municipalities. Pursuant to this decision, the government declared that all state-owned property that is financed from a municipal budget or included in the municipal balance sheet shall be deemed municipal property. In the event that the particular property is necessary to ensure the interests of the state, it must be retained by the state.

The procedure for the transfer of the state-owned property supervised by the ministries was as follows:

- 1) The ministry shall draft lists of state-owned property in each region and city to be transferred to municipalities and submit them to the municipal department of the Council of Ministers.
- 2) The municipal department shall group the lists by region and city and send them to the respective municipalities.
- 3) The local governments review the lists drafted by the ministries, agree or reject the objects listed, and prepare proposals on the transfer of state-owned property not included on the lists.
- 4) Municipalities send their decisions to the municipal department, which compiles them and prepares a draft decision of the Council of Ministers on the transfer of state-owned property to municipalities.
- 5) In case of dispute, the municipal department shall organize a meeting of the interested parties. If no agreement can be reached, the municipal department shall propose that the issue be decided upon by the Council of Ministers, taking into account the opinion of the commission on national property protection and conversion.
- 6) On the basis of the government's decision, the ministries transfer the property to the selected municipalities.

The transfer of the state-owned agricultural enterprises was organized in an even simpler way:

- 1) Municipalities draft a list of objects they are interested in and submit it to the agricultural enterprise.
- 2) A decision on the transfer is made by the administration of the state-owned agricultural enterprise.
- 3) If there is no dispute, the transfer of the state-owned property takes place after the municipality makes its decision. In case of dispute, the municipal department organizes a meeting of the interested parties. If no agreement can be reached, the municipal department proposes that the issue be decided upon by the Council of Ministers.

- 4) By December 1, 1991 municipalities compile data about the property transferred to them and submit it to the municipal department and the ministry of agriculture.

From July 22, 1991 to August 2, 1993, the Council of Ministers issued 21 decrees, whereby a large part of state-owned property was transferred to municipalities. The main practical problem the government had to deal with at that time was the fact that governmental institutions were willing to get rid of unprofitable objects, but municipalities wanted to take over objects with high profitability. The large-scale process of separating state-owned property and municipal property was completed in December 1994 when the above decision of the government was cancelled.

The privatization process in Latvia was first commenced in the trade and service industries. Such a sequence was logical: trade, public catering and service enterprises were small, not requiring big investments. The capital turnover in these companies was faster, and the level of risk was smaller. Their purchase also required fewer resources.

On November 5, 1991 the Law on the Privatization of Small Municipal Objects of Trade, Public Catering and Services was passed. This law applied to objects which were owned by municipalities (transferred from state ownership) and which met at least one of the following three requirements:

- trade technology units with a sales hall not exceeding 100 square meters;
- public catering units with premises not exceeding 120 square meters and 30 seats;
- services with fewer than 10 staff members.

The practical implementation of the law soon demonstrated that objects which did comply with the above parameters should also be deemed fit for privatization. On February 25, 1992 the size limitations were removed from the law.

The law provided for the following types of privatization:

- 1) auction among the employees;
- 2) auction to selected bidders;
- 3) general auction (excluding the state);
- 4) direct sale to employees;
- 5) open direct sale (excluding the state).

Only the fixed assets and current assets of the object could be privatized, while the buildings in which they were located were leased to the privatizing agent for five years. If during this period the privatization agreement was abided by, the privatizing agent could purchase the building(s). Initially the right of first refusal was assigned to employees on the condition that they had worked in connection with the

object for at least five years. On February 25, 1992 this provision was cancelled.

The practical application of the law demonstrated that apart from assigning municipalities the right to conduct privatization, incentive and control mechanisms should be created simultaneously. There were some municipalities where the privatization of small objects proceeded in an organized manner, with a uniform approach both with respect to the selection of privatization methods and the sale price. In other municipalities, where the municipal bureaucracy was closely linked with local business circles, the selection of objects to be privatized was biased. In July 1992, in order to put moral pressure on municipalities, Parliament authorized the government "to improve the provision of inhabitants with food products." On the basis of the above authorization, a special governmental commission was established which dealt with the de-monopolization of trade and privatization. The commission was entitled to request that municipalities draft privatization plans for particular cases. In some cases, the commission initiated criminal proceedings against municipal employees.

This law expired on July 5, 1994, when general privatization regulations were applied to the privatization of municipal trade, public catering and service enterprises.

In order to ensure information flow between municipalities and government institutions, municipalities were allowed to send a representative to the commissions arbitrating the privatization of state-owned enterprises. This also allowed municipalities to influence privatization regulations. In 1994, this relationship was cancelled when the government established a central privatization agency.

For municipalities, the most important benefit of the privatization of the state-owned enterprises was financial. Pursuant to the Law on Privatization Funds for State-Owned and Municipal Property, the municipality receives 10% of the resources generated through privatization. This motivates municipalities to support the privatization of state-owned enterprises. Moreover, the generated resources can be used for the support of the local private companies and job creation.

A feature of property reform in Latvia was the initial separation of the ownership of buildings from the ownership of the land on which they stand. Only after the Civil Code was reactivated in 1993 were these rights reunited. Therefore, land reform proceeded separately from the privatization of buildings and enterprises.

Land reform began with the restoration of ownership to pre-WWII owners. For the purposes of reform, land was categorized either as urban or rural.³⁵

Reform was implemented in a way that intended to maximize common interests between the public, former

owners, their heirs, current land workers and prospective owners and managers. Land reform was financed by the state.

In order to coordinate the activities of land reform and ensure its legality in compliance with the Law on Land Commissions, the *Saeima* established a central land commission; municipalities established city or parish land commissions respectively.

The implementation of land reform in cities and in rural areas differed:

- In rural areas, land reform began a year earlier (the deadline for the submission of applications was June 20, 1991), and there were more restrictions than for urban land.
- During land reform in rural areas, the Civil Code was reapplied, considerably extending the range of the prospective heirs of the former landowners.
- Only in rural areas were there separate cases when the property compensation vouchers were exchanged for cash.
- In cities, land reform began a year later (the deadline for the submission of applications was June 20, 1992).
- Unlike in rural areas, the restitution of land ownership rights in cities was not subject to the condition of permanent use of the land.
- In cities, ownership rights were primarily restored with respect to old borders.

Until 1940, the state and municipalities owned considerable areas of land (approximately 25%), as well as up to 50% of woodland; beyond that, some urban land was not registered in the land registry.

During land reform:

- 1) Large areas of the former state-owned and municipal land were transferred as an equivalent compensation to those persons for whom land ownership rights could not be restored in line with respect to old borders.
- 2) The state and municipalities could retain land not claimed by former owners.
- 3) When determining whether land was owned by the state or a municipality, the key criterion was the ownership of the buildings located on the land.
- 4) Disputes arising during the course of land reform were resolved by the central land commission or the court.

In 1938, Riga had 6,800 hectares of woodland within its administrative borders and 78,130 in other regions of the country. In 1999, the city had restored ownership of 5,819 hectares of woodland within its administrative borders and approximately 50,000 hectares outside the borders. The Riga municipality is the second largest public owner of woodland after the state.

Land reform in rural areas proceeded in two stages: the first stage from 1990 to 1996, the second from 1993 intended to be completed by 2005.

During the first stage of land reform, beginning June 20, 1991, former landowners, their heirs, all current users of the land and the other claimants submitted applications for the use of land in rural areas. After review of the applications, a land utilization plan was developed for each parish, and subject to that, further decisions on the transfer of land for permanent use were made, and borders of the allocated land were allotted on the spot.

In each parish, a land commission was established with the following functions:³⁶

- 1) Register, compile and analyze applications for land, and submit their decisions to the head of the parish land utilization agency for implementation.
- 2) Review and adjust the parish land utilization plan and submit it to the parish council for approval.
- 3) Resolve land disputes within the framework of its competence.
- 4) Issue opinions on land ownership rights; make decisions on land ownership compensation matters and land use rights, as well as make decisions on the restitution of land ownership rights, transfer of land to the ownership for payment, as well as on determining the amount of payment.
- 5) Review unsatisfied claims.
- 6) Review proposals for the further use of unclaimed land.
- 7) Issue statements on the initial data for the calculation of land tax.
- 8) Review proposals for the use of the communal land of the parish.
- 9) Make decisions for the purposes of the use of land to be sold to legal entities, and on areas where land is to be used for business.
- 10) Approve the scale of land plots and their borders, if the corroboration request on the registration of the buildings in the land registry was submitted prior to the entrance of the land in the land registry.

The activities of land reform were performed by the state land service and funded from the state budget, except for the marking of the borders of land transferred for use (the responsibility of the state land service).³⁷ It was the duty of municipalities to control land use and protection.³⁸

Municipalities also submitted applications on the allocation of land for the needs of municipalities. Municipalities claimed land for the following purposes:³⁹

- common needs (maintenance of streets, squares, parks, cemeteries, water systems, waste dumps, roads of local importance, municipal utilities, cultural and social objects);
- maintenance of personal auxiliary farms;

- maintenance and construction of municipal buildings and structures;
- other business activities.

Land was transferred to municipalities for permanent use for the following purposes only: 1) agriculture, 2) forestry, 3) water supply, 4) manufacturing, 5) construction and maintenance of objects of culture, education, health care, sports, trade and other non-production spheres, 6) building and maintenance of power transmission, communications lines, transport and other public utilities, 7) establishment and maintenance of streets, squares, parks, cemeteries, sanitation objects and other facilities of common use), 8) construction and maintenance of residential houses, summer houses and garages, 9) maintenance of specially protected nature and cultural-historical heritage objects.

Both individual persons and legal entities could apply for use of water systems and the land occupied by them. The rights to use of the land were documented simultaneously with the rights to use the waters.⁴⁰

During the second stage of land reform the following activities were performed:

- 1) Restitution of land ownership rights or transfer of land without compensation.
- 2) Assessment of land not distributed during the first stage of land reform, development and implementation of a plan for its use.
- 3) Survey of the borders and territories of allocated land and development of maps of used land plots.
- 4) Registration of land and other natural resources in the cadastre and estimation of the value of the real estate.

When land reform started in cities, all land, including woodlands and waters, within the administrative territories of a city was transferred to its local government of at the time ownership rights were settled.⁴¹

A land commission was established in each city with the following functions⁴²:

- 1) Notify the applicant in writing on receipt of the application.
- 2) Compile and analyze applications for land and submit decisions to the city council for preparing a land utilization plan; issue opinions on land ownership or land use rights and make decisions on land ownership compensation matters. After borders have been surveyed and the deed of the land border survey and the plan of the land borders have been prepared, make decisions on the restitution of land ownership rights; transfer land for payment.
- 3) Review and adjust the land utilization plan contained in the master plan of the city and submit it to the city council for approval.

- 4) Resolve land disputes within the framework of its competence.
- 5) Cooperate with the land commissions of neighboring parishes and cities on the issues of the land of suburbs, green belts, common municipal utilities, transport and communications lines.
- 6) Review proposals on measures for satisfying unsatisfied claims, taking into account proposals from the land commissions of neighboring parishes and cities.
- 7) Review proposals on the further use of the unclaimed land.
- 8) Issue statements on initial data for the calculation of the land tax.
- 9) Make decisions on the purposes of the use of land to be sold or acquired at auction to legal entities, and on the area of the land to be used for business.

City councils have the following duties:

- 1) Review the decisions of city land commissions received by way of appeal on the restitution of land ownership rights, transfer of land for payment and compensation and make decisions accordingly.
- 2) Assign land for use.
- 3) Sell municipal land to individual persons and legal entities.
- 4) Retain land to be reformed by the municipality.

Land reform in cities was conducted in three stages:⁴³

- 1) receipt of applications for land;
- 2) restitution of ownership rights, planning of land use and termination of land use rights;
- 3) transfer of land.

During the first stage, the former owners, current users and other applicants submitted their applications for land.

As in rural areas, land ownership rights in cities were restored both to Latvian citizens and foreigners, as well as to legal entities who owned land in Latvia on July 21, 1940.

The law stipulated the following cases when the former owners could not reacquire land in its original borders:

- If Latvian citizens have built or are building residential houses on the land or had acquired residential houses by June 20, 1992 according to the law.
- If the land had been allocated to a member of a gardening society for planting an orchard, with the rights to construction.
- If specially protected national natural objects are located (wholly or partially) on the land approved by the state committee of environmental protection.
- If they contain educational, cultural, sports, public utility, transport or science facilities of national importance. In such cases, ownership rights to the land shall be given

to the state or respective municipality when the former landowners or their heirs receive compensation.

A provision was included in the law,⁴⁴ stipulating that by decision of the city authority, if there are no suitable plots within its jurisdiction, compensation shall be paid. Such decisions may be appealed in court.

2.5 The Process of Property Transfer from State to Municipality

This section describes the procedure of state-owned property transfer to municipalities in force in 2002. This procedure, with minor changes, has been applied since 1994, when large-scale transfer of property to municipalities was completed.

2.5.1 Legal Decisions Required for Property Transfer

A decision on the transfer of state-owned property to a particular municipality is made by the Council of Ministers. The Council of Ministers makes its decision on the basis of a proposal prepared by the ministry or another public institution and a decision of the of the respective municipal council.

The legal basis for making such a decision differs for each type of property.

- Property possessed by state civil institutions⁴⁵ may be transferred to municipalities without compensation, unless it is necessary to the respective civil institution itself or other state civil institutions for the implementation of their tasks.⁴⁶ A decision by the Council of Ministers is necessary for the transfer of both immovable and movable state-owned property to a municipality without compensation.
- Communal objects which were excluded from the privatization of state-owned enterprises and companies designated for privatization may be transferred to the local government of the respective administrative-territorial unit by decision of the Council of Ministers.⁴⁷
- The Council of Ministers has the right to transfer to municipalities all other movable and immovable state-owned assets, as well as equity shares owned by the state in companies.⁴⁸

2.5.2 Time-frame of Property Devolution

In order to transfer property, a statement of intent from the municipality to take the property and a decision by the Council of Ministers on the transfer of the property are required.

The institution authorized by the Council of Ministers and the institution or person authorized by the municipality then signs the deed. If the transferred property is real estate, buildings or equity shares in a company, information about the change in ownership rights shall be registered with the land registry or the enterprise registry.

Depending on the scale of the municipality, the bureaucratic process takes from a week to two months.

Pursuant to the provisions of the rules of procedure of the Council of Ministers, in order to pass, a decision of the Council of Ministers must be publicly announced at a meeting of state secretaries, then approved by the ministry of justice, ministry of finance and other relevant ministries. After approval, the draft must be reviewed by the ministerial committee, and after the draft has been formalized, it must again be approved by the Council of Ministers. This process often takes from one to three months.

A prerequisite for signing a deed of transfer is the examination of documents certifying ownership rights of the property to be transferred, inventory files, as well as examination on by the institution taking over the property. The signing of the deed normally takes place within two weeks and up to one month after the decision of the Council of Ministers has been passed.

Hence the time-scale for a transfer of state-owned property is between seven weeks and six months.

2.5.3 *Organizational and Institutional Setting of Property Devolution*

No special institutions have been established for the transfer and takeover of state-owned property.

The institution that possesses the respective state-owned property is responsible for the property transfer on behalf of the state. The head of the respective institution establishes a commission for the property transfer or appoints a staff member to handle the issues of property transfer. In ministries, this function is performed by the administrative department; in other institutions, by legal or technical structural units.

Also property takeover on behalf of a municipality is organized by a municipal structural unit responsible for the management of municipal property. In the largest municipalities, this function is performed by the authority of municipal property affairs; in smaller ones, by the legal or technical service of the municipality. After property takeover, these structural units also register property in the name of the municipality with the respective registers.

2.5.4 *Valuation and Assessment of Property*

Since state-owned property is transferred to municipalities without compensation, the issues of property valuation need not be resolved in the process.

If a municipality intends to relinquish or sell the real estate transferred to it, it must carry out the valuation of the property itself; real estate must be sold at auction. The law provides for the following special exceptions when real estate may be relinquished or sold without auction:

- If the auction has been unsuccessful.
- If the residual balance sheet value of the movable assets for sale is less than 500 lats.
- If the costs of holding an auction exceed the value of the assets.
- If the right of first refusal to the real estate is retained by the landowner.

Property valuation is organized by the Commission on Privatization of Municipal Property privatization, a permanently functioning commission for the privatization and valuation of municipal property established by the municipality.

During the course of valuation at first an objective audit of the assets, liabilities and equity of the object is conducted. No specific valuation methods are stipulated by law. Normally the privatization commission invites a qualified expert for the valuation of the object—a real estate company if the object to be valued is real estate, property, or an auditing or accounting firm if the object is a company.

If the property to be valued is not too complicated, its valuation can be accomplished within one month.

2.5.5 *Ownership and Value Registration Institutions (the Enterprise Registry, Cadastral Registry and Land Registry)*

The Enterprise Registry

The enterprise register of Latvia is an administrative state institution which registers enterprises (companies), their branches and representative offices in the territory of Latvia, as well as all amendments to the corporate governance documents; it also performs other activities as stipulated by legislative acts. The enterprise registry registers mass media, nongovernmental organizations, commercial pledges, dominant interests and marriage contracts.

The enterprise registry is a legal entity operating under the supervision of the ministry of justice, and its activities are regulated by the Law on the Enterprise Registry and its internal regulations approved by the Council of Ministers.

Its head is the chief notary public of the state, who is appointed or dismissed by the Council of Ministers, following a recommendation from the minister of justice. This institution consists of the main office, as well as eight regional departments in the largest centers of Latvia. The main office of the enterprise registry ensures the registration and other functions in Riga, as well as organizes the work of the regional departments.

Registration is the key function of the enterprise registry. It ensures a uniform system of records about the registered objects. Pursuant to provisions in several laws, the enterprise registry registers the following objects:

- enterprises, their representative offices and branches;
- mass media;
- nongovernmental organizations and their associations;
- holding company agreements;
- concession agreements;
- representative offices of foreign firms;
- representative offices of foreign organizations;
- commercial pledges;
- marriage contracts;
- dominant interests in accordance with the Law on Holding Companies.

The second function of the registry is to control compliance with the laws and regulations of the founding and corporate governance documents submitted by the objects to be registered.

Its third function is to provide information on registered objects.

The enterprise registry performs many other functions assigned to it by several laws and regulations:

- reports to the respective state institutions on particular breaches of law or submission of inaccurate information;
- publishes information on enterprises in the press as stipulated by law;
- ensures mutual exchange of information with state and municipal institutions;
- approves experts for the valuation of capital investment in joint stock companies;
- issues penalty documents in cases of administrative breaches;
- performs the functions of an administrator in enterprise and company insolvency processes;
- commences enterprise and company liquidation processes;
- receives annual reports from enterprises;
- deletes failed enterprises from the register.

The enterprise registry makes records in the respective file within 30 days after the submission has been received.

For an additional fee, the enterprise registry makes the record within one day.

The Cadastral Registry

The real estate cadastral registry was established pursuant to the Laws on State Land Service, Real Estate Tax and Regulations of State Real Estate Cadastral Registry approved by the Council of Ministers, in order to develop a state-of-the-art computerized registration system for real estate, lawful possessions, use and tangible objects contained therein, which would ensure the registration of ownership rights and resolution of issues related to real estate tax.

Objects to be registered with the cadastral registry include real estate (land, structures and apartments), leases and tangible objects forming the real estate—plots of land (whole or partial), buildings and groups of premises.

The tasks of the cadastral registry are to compile, systematize, update and issue data on the following subjects:

- cadastral valuation and real estate tax administration;
- registration of ownership rights to real estate;
- providing necessary information to clients on the use of real estate and its development;
- concluding real estate transactions;
- planning of national, regional and municipal economic and territorial development;
- land utilization and environmental protection;
- preparation of state statistical information and state land balance sheets;
- development and maintenance of the geographical information systems;
- ensuring the interests of holders of other registers and information systems, etc.

a) Textual Section of the Cadastral Registry

The cadastral registry ensures the registration, maintenance and updating of data on real estate, lawful possessions, use, lease, and tangible objects contained therein in a definite administrative territory.

The cadastral registry has the following functions:

- 1) Input data from the decisions of municipalities and land commissions, real estate registration documents, real estate survey and valuation files and other sources.
- 2) Create mutually linked and compatible tables, ensure historical data storage and prevent data duplication.
- 3) Regularly update information.
- 4) Select and provide data in various ways, including on electronic data carriers.
- 5) Register the internal and external users of the cadastral registry.

- 6) Link with other registers and information systems.
- 7) Provide data to governmental and municipal authorities necessary for land administration.
- 8) Calculate real estate tax.
- 9) Issue statistical surveys.

b) Graphic Section of the Cadastral Registry

The cadastral map is part of the Latvian map system. It shows the objects of cadastre with the accepted symbols in compliance with the cadastral map standard.

The cadastral map covers all territory of the Republic of Latvia, and serves as an overview of the location of land plots, buildings, encumbrances on the real estate usage rights, and leased objects in the territory. The map shows the cadastral territory and borders of cadastral groups, borders of land plots and their cadastral symbols, outside contours of buildings and their cadastral symbols, territories taken up by encumbrances on the real estate usage rights and their symbols; leased objects and their cadastral symbols, and borders of the Republic of Latvia administrative-territorial division.

The state land service makes records all relevant documents received in the cadastral registry within five days.

The Land Registry

Land registries are public books established for the registration of rights to real estate. Land registry institutions are part of judicial power, and the power to record ownership in a land registry is held by judges.

Activities of the land registry institution are intended for the protection of the rights of creditors, so that the registration of pledge rights in the land registry would be as secure as taking movable assets as collateral. The land registry system provides real security for liabilities. Each real estate is registered as an independent plot of land in a separate land registry folio; thus it becomes a mortgage unit and as such is fully liable for all property rights recorded in this folio.

Pursuant to the Law on Land Registries, all real estate recorded in land registries and the rights related to them are registered. Land registries are available to anyone.

Land registries consist of folios. Each folio has four parts where data on the following subjects is recorded:

- 1) real estate;
- 2) ownership of real estate;
- 3) encumbrances on real estate;
- 4) debts on real estate.

A separate folio in the land registry is opened for each independent property. All rights, rights securities and restrictions, as well as modifications and deletions of these

rights, securities and restrictions on real estate are recorded in the folio.

Only after a transaction has been recorded in the land registry, does it take effect against third parties. Prior to being recorded the transaction does not entail property rights, only a basis for acquiring such rights.

Land registry institutions are located in each region in Latvia. Databases of all 28 land registry departments are linked in the united computerized land registry—the central database from which information on all properties recorded in the land registry in this country can be obtained.

The law stipulates that a judge shall take a decision on making a record in the land registry within 30 days after all relevant documents have been received. Upon payment of a state fee ten times the regular one, the decision is made within three days.

2.5.6 Disputes and their settlement

There are no institutions in Latvia whose functions would include resolution of disputes between the state and municipalities. Transfer of state-owned property to the ownership of municipalities is an unsolicited transaction on the part of the state; likewise the municipality is sovereign in its rights to decide on the necessity to accept the state-owned property being offered. Hence, if one of the parties is not willing to transfer or accept the property (when an official decision is made), the process centers on negotiations to agree on terms and conditions of the transfer. In some cases, as a result of such negotiations, the state transfers resources for the maintenance and management of a transferred property, or to cover debt attached to the property.

After a formal decision has been made by both parties, the interested party may claim compulsory enforcement of the decision made in court; however, no such cases have occurred. During negotiations where the interested officials take part, conditions of property takeover are discussed. There have been cases when after election, new members of a council cancel the decision made prior to their mandate.

2.6 Management of Municipal Property

2.6.1 Property Management

The Law on Local Government stipulates that a municipality may own land, waters, woods, movable assets, real estate, financial and other resources.

Municipalities enjoy the following wide scope of rights pertaining to the management of their property:

- 1) to establish municipal enterprises;
- 2) to participate in companies of mixed equity;
- 3) to relinquish or sell movable and immovable assets through their sale or investment;
- 4) to sell municipal enterprises and parts of thereof;
- 5) to sell equity shares owned by themselves both in companies with mixed equity and fully owned by the municipality;
- 6) to pledge property which is not needed for performing regular functions;
- 7) to transfer property to the state without compensation;
- 8) to conclude deals and perform other activities pertaining to private law.⁴⁹

However, the right enjoyed by a municipality to manage its property independently does not mean that the municipality may deal with it without any restrictions whatsoever. The law stipulates definite restrictions both regarding the purpose of their activities and the procedure, thus limiting the freedom of action of the municipality.

When making decisions on activity concerning its property, the municipality must ensure the implementation of its functions. These functions, listed in Article 15 of the Law on Local Government are focused on providing services to inhabitants, and for the most part these services are important and specific, requiring know-how, experience and considerable investments (for instance, education, sanitary maintenance of the territory, health care or social assistance). Bringing profit by providing such services could affect the interests of inhabitants in a negative way, since these services must be provided to the needy. Therefore, the provision contained in Article 77 of the Law on Local Government seems logical—the municipal enterprises providing services to the inhabitants should not gain profit from their core operations; however, should profit be generated, it is allocated for the development of the enterprise.⁵⁰

The implementation of municipal functions as a precondition must be taken into account when municipal property is relinquished or sold, including during privatization. The municipality may not, for instance, privatize the only waste-collecting enterprise without stipulating the conditions for retaining the previous line of business operations, thus creating the hazard of leaving the inhabitants without any provider of such services at all.

The law also stipulates that a municipality has the right not to designate apartment houses, hostels, social residential houses and apartments for privatization as they are necessary for the implementation of municipal functions.

The other restriction is the provision that the municipality shall deal with its assets rationally and efficiently, in a

useful manner. This was stipulated both in the Law on Local Government⁵¹ and the Law on the Prevention of the Squandering of State and Municipal Assets and Financial Resources.⁵² Moreover, the latter stipulates that the activities of municipalities and municipal enterprises shall be as follows: the selected goal must be achieved with the least necessary financial resources and assets; municipal assets shall be sold or transferred for a maximum price. Hence, when making a decision on the sale or relinquishing of property, the municipality must consider both the opportunities of further utilization of the property for the benefit of the inhabitants, as well as options of how the sale price of such encumbered property could be maximized.

Municipal institutions and enterprises where state-owned or municipal shares jointly or separately exceed 50% may not issue loans or give undertakings and guarantees, except for cases when the respective municipality agreed to the issue of such loans, undertakings and guarantees.

As regards the procedure, municipalities encounter restrictions with respect to decision-making—Article 49 of the Law on Local Government provides for the right of a specially-assigned reform minister, authorized by the Council of Ministers, to suspend the effect of individual decisions. Decisions on the privatization of business property and similar cases must be approved by the ministry of economy (the ministry assesses the lawfulness of the privatization plan).

Sometimes municipalities are limited in the type of sale they select. Article 78 of the Law on Local Government stipulates as follows: “A municipality which has acquired real estate on the basis of the right of first refusal, over the next five years may sell it at public auction only.”

Latvian law does not provide for any special limitations for the sale of particular groups of property (e.g., schools, hospitals, etc.). At the same time, there have been no cases when municipalities would commence the sale of such property without reason. The fact that local governments are elected bodies and their decisions are public often prevents them from making apparently unreasonable decisions. For instance, the local government of Edole, a small town, intended to lease a complex of historical buildings (an ancient castle) to a wealthy Latvian businessman for 99 years. As a result of protests from inhabitants the decision was rescinded, and the municipality committed to restore the buildings and turn the complex into a museum.

2.6.2 *Institutions Controlling Municipalities*

2.6.2.1 *Control Restricted to Legality*

An illegal decision by a council is suspended by order of the minister of municipal affairs. The order must be published

in the official journal within three days and sent to the chairperson of the council responsible for its implementation.

The chairperson of the council must convene a meeting of the council within two weeks from the date he/she receives the order from the responsible minister. A decision must be adopted declaring the illegal decision null and void, or harmonizing it with existing laws and regulations.

The chairperson has the right, without convening a specific sitting, to submit an application to the court with a claim to declare the order of the responsible minister null and void.

2.6.2.2 *Local and Regional Accounts Auditing*

An audit commission is elected by the council from among the voters of the respective administrative-territorial unit, proportional to the number of deputies from each political organization or voters' associations elected in the council.

The audit commission has the following functions:

- Control expenditure of municipal resources according to accepted budget provisions and estimates.
- Check legality or financial activity and rationality of the managers and officials of municipal enterprises and institutions.
- Control whether the municipal financial resources, movable property and real estate is managed in accordance with the councils' decisions and interests of inhabitants.
- Participate in the audit of municipal property and financial resources organized by the state audit office.

2.6.2.3 *Other Forms of Control*

In accordance with the Law on Local Government, the state audit office controls the economic activities of local authorities. The office audits the management of assets and financial resources by municipalities, the privatization of municipal property, as well as auditing annual municipal annual. In auditing the annual reports of 575 municipalities for 2000, the municipal audit department identified that 58.09% or 334 annual reports contained material faults in accounting and bookkeeping. Overall, 578 municipalities should have submitted their financial annual reports, enclosing a report by a sworn auditor, to the state audit office. However, two of them did not submit a report, and one annual report was without an auditor's report; thus it was not deemed acceptable.

The reports 36.17% or 208 municipalities were approved; 28 were not. Five municipalities were refused an opinion, as the report of the sworn auditor did not provide adequate basis for the state audit office to make an assessment.

Local budgets constitute a part of the state budget and are accordingly included in national financial and economic planning.

In accordance with the Law on Local Financial Stabilization and Supervision of Local Financial Activities, financial restrictions are imposed on local government in the following cases:

- when the volume of local financial liabilities which have reached the term of payment exceeds 20% of the respective annual budget;
- if the local government is unable or, according to proven circumstances, will be unable to settle its commitments;
- if local property is endangered due to debt recovery.

In these cases, the local chairperson, the responsible minister, the finance minister or the state controller can call for financial stabilization. The local government discusses the issue, and, if it is adopted, a financial stabilization announcement is prepared. If the local government is against it, a substantiated letter is sent to the responsible minister and the minister of finance. The minister of finance makes the final decision on financial stabilization.

If a decision for financial stabilization is affirmed, the ministry of finance appoints a special supervisor for the local authority in question. The supervisor must develop a financial stabilization plan. The supervisor is remunerated from the state budget.

2.7 **Municipal Property as a Source of Local Revenue**

Local government revenue includes tax and non-tax revenue, government subsidies and special purpose subsidies, as well as local government special budget revenue. Each year, prior to drawing up the local government budgets, the Council of Ministers has negotiations with the union of municipalities. As a conclusion to negotiations, a letter of understanding is signed defining the amount the government will contribute to local government budgets.

The largest source of local government budget revenue is personal income tax, accounting for an average of 43% of the local government total budget revenue. 71.6% of the collected personal income tax is transferred to the local government budget; the remaining 28.4% is transferred to the health care budget. Overall, tax revenues account for 54% of total revenue in the local government budgets.

Local government non-tax revenues contain revenues from business activities and property, charges and dues, revenue from the sale of municipal real estate and land, as well as penalties and sanctions. Local governments' own revenue contains revenue from paid services.

Transfers from other budgets, accounting for approximately a quarter (25%) of the local government total revenue, comprise payments from the state budget both by way of subsidies and special purpose subsidies. Special purpose subsidies are allocated money transfers to a local government budget for a specified activity. The item “transfers from other budgets” contains payments from the Local Government Financial Equalization Fund.⁵³

Key local government special budgets include the Municipal Road Fund, the environmental protection budget and the Municipal Property Privatization Fund. Pursuant to the Council of Ministers’ regulations on the state and municipal road funds, established on June 20, 2000, the Municipal Road Fund comprises 30% of the fees collected on vehicles and 30% of a share of excise taxes transferred annually to the State Road Fund (after the expenditure of financing the development of rural roads, of the special purpose subsidy for ensuring the regular passenger bus service, deductions from the excise tax to the Railway Infrastructure Fund for the fuel used in railway shipments, as well as the payments stipulated by regulatory documents have been deducted). The local government special budgets of environmental protection receive 60% of the revenue from natural resource taxes for the extraction of natural resources or pollution of the environment within the stipulated limited amounts.

In 2002, the revenue of the local government special budget was estimated at 35.58 million lats, including reve-

nue from natural resources taxes (2.01 million lats), revenue from the privatization fund (0.89 million lats), revenue from the road fund (15.3 million lats), revenue from regular passenger bus service (3.38 million lats), revenue from donations and gifts (4 million lats) and other revenue (10 million lats).

Revenue from commercial use of municipal property is included under local government non-tax revenue. Its percentage has gradually decreased from 5% to 2–3% of total local government revenue. Local government revenue from privatization and the sale of real estate and land accounts for only a small portion of the local government total revenue, 2% on average.

Public–Private Partnership (PPP) Activities

Although a legislative framework for PPP activities is in place in Latvia (established in 2000 with the Law on Concessions), both governmental and municipal authorities lack experience in implementing such a mechanism. Some municipalities have tried to launch pilot projects for implementing PPP (for instance, the transfer of a hospital or the main street of a town to private managers); but not one has been implemented as yet. In order to facilitate PPP activities, the Council of Ministers approved a concept paper on concession facilitation in April 2002, establishing a special concession unit in the national development agency.

Table 3.3
Local Government Budget
[in Millions of Lats]

	1998	1999	2000	2001	2002 (Estimate)
REVENUE	395.6	413.5	441.1	449.6	470.5
1. Local government basic budget revenue	350.1	366.6	386.4	411.8	434.9
1.1. Tax revenue	206.8	219.8	231.0	249.2	264.5
incl. Personal income tax	157.8	171.4	185.9	203.3	221.4
Property tax	48.3	47.3	44.0	44.9	41.4
Internal tax for services and goods	0.7	1.1	1.2	1.0	1.7
1.2. Non-tax revenue	19.8	19.4	17.9	17.5	17.3
1.3. Own revenue	24.5	26.4	25.8	25.3	25.4
1.4. Transfers from other budgets	99.1	101.0	111.6	119.8	127.7
2. Local government special budget revenue	45.5	46.9	54.7	37.8	35.6
EXPENDITURE	394.2	424.3	456.6	460.1	482.0
1. Local government basic budget expenditure	354.0	377.2	407.7	415.4	438.9
2. Local government special budget expenditure	40.2	47.1	48.9	43.6	43.1
Financial balance	1.4	-10.8	-15.5	-10.4	-11.5
NET LOANS	9.1	3.6	-2.5	0.0	0.0
Fiscal balance	-7.8	-14.4	-13.0	-10.4	-11.5
FINANCING: LOANS FROM STATE BUDGET	7.8	14.4	13.0	10.4	11.5

Table 3.4
Local Government Budget
[in % of GDP]

	1998	1999	2000	2001	2002 (Estimate)
REVENUE	11.0	10.6	10.2	9.5	9.1
1. Local government basic budget revenue	9.8	9.4	8.9	8.7	8.4
1.1. Tax revenue	5.8	5.6	5.3	5.2	5.1
incl. Personal income tax	4.4	4.4	4.3	4.3	4.3
Property tax	1.3	1.2	1.0	0.9	0.8
Internal tax for services and goods	0.0	0.0	0.0	0.0	0.0
1.2. Non-tax revenue	0.6	0.5	0.4	0.4	0.3
1.3. Own revenue	0.7	0.7	0.6	0.5	0.5
1.4. Transfers from other budgets	2.8	2.6	2.6	2.5	2.5
2. Local government special budget revenue	1.3	1.2	1.3	0.8	0.7
EXPENDITURE	11.0	10.9	10.5	9.7	9.3
1. Local government basic budget expenditure	9.9	9.7	9.4	8.8	8.5
2. Local government special budget expenditure	1.1	1.2	1.1	0.9	0.8
Financial balance	0.0	-0.3	-0.4	-0.2	-0.2
Net loans	0.3	0.1	-0.1	0.0	0.0
FISCAL BALANCE	-0.2	-0.4	-0.3	-0.2	-0.2

NOTES

- ¹ Data provided by the Central Statistical Bureau at the beginning of 2002.
- ² Statistics prepared by the Authority of Municipal Affairs at the beginning of 2001.
- ³ Statistics prepared by the Authority of Municipal Affairs at the beginning of 1999.
- ⁴ 1 Latvian lat (LVL) = 0.595 EUR = 0,604 USD in October 1, 2002
- ⁵ Articles 3, 4, 5 and 6 of the Law on State and Municipal Ownership Rights to the Land and Their Registration in Land Registries.
- ⁶ The date when the Republic of Latvia was declared a part of the Soviet Union.
- ⁷ According to the Law on Privatization of State-Owned and Municipal Property.
- ⁸ Section 2 of the Law on Land Privatization in Rural Areas.
- ⁹ Article 19 of the Law on Land Privatization in Rural Areas.
- ¹⁰ Section 6 of the Law on Land Privatization in Rural Areas.
- ¹¹ Section 6 of the Law on Land Reform in Cities and Towns.
- ¹² Article 2 of the Law on Land Privatization in Rural Areas.
- ¹³ Articles 1128 and 1129 of the Civil Code.
- ¹⁴ Article 1102 of the Civil Code.
- ¹⁵ Article 1103 of the Civil Code.
- ¹⁶ Article 24 of the Law on Regulation of the First Stage of Land Reform in Rural Areas.
- ¹⁷ Article 2 of Law on the Land Privatization in Rural Areas
- ¹⁸ Article 1110 of the Civil Code.
- ¹⁹ Item 17 of the Council of Ministers' Regulations on the Lease and Use of Water Bodies and Industrial Fishing Rights.
- ²⁰ *Ibid.*, Item 86.
- ²¹ The Council of Ministers' regulations on permission for water use.
- ²² Article 3 of the Law on Mineral Wealth.
- ²³ *Ibid.*, Article 8.
- ²⁴ Article 4 of the Law on the Privatization of State-Owned and Municipal Property.
- ²⁵ This 'bottom-to-top' approach is opposite to the approach currently used in the privatization of state property, meaning that state institutions play an active role in the initiation of privatization.
- ²⁶ Article 31 of the Law on Privatization of State-Owned and Municipal Property.
- ²⁷ Article 35 of the Law on Privatization of State-Owned and Municipal Property.
- ²⁸ Article 6 of the Law on Privatization of State-Owned and Municipal Property.
- ²⁹ Article 41 of the Law on Privatization of State-Owned and Municipal Property.
- ³⁰ Article 42 of the Law on Privatization of State-Owned and Municipal Property.
- ³¹ Article 47 of the Law on Privatization of State-Owned and Municipal Property.
- ³² Article 4 of the Law on Privatization Commissions on State-Owned and Municipal Property.
- ³³ Article 4 of the Law on Privatization of State-Owned and Municipal Property.
- ³⁴ Report on the Economic Development of Latvia, the Ministry of Economy, Riga, 2002.
- ³⁵ Article 2 of the Law on Land Use.
- ³⁶ Article 2 of the Law on Land Commissions.
- ³⁷ Article 22 of the Law on Land Reform in Rural Areas.
- ³⁸ Article 40 of the Law on the Use of Land.
- ³⁹ Item 47 of the Decision of the Presidium of the Supreme Soviet on the Regulation of the First Stage of Land Reform in Rural Areas.
- ⁴⁰ Item 24 of the Decision of the Presidium of the Supreme Soviet on the Regulation of the First Stage of Land Reform in Rural Areas.
- ⁴¹ Article 4 of the Law on Land Reform in the Cities.
- ⁴² Article 2 of the Law on Land Commissions.
- ⁴³ Article 5 of the Law on Land Reform in Cities.
- ⁴⁴ Article 12 of the Law on Land Reform in the Cities.
- ⁴⁵ A civil institution—all institutions of state administration, courts, public prosecution offices and the state audit office, as well as other governmental institutions financed from the state budget.
- ⁴⁶ Article 4 of the Law on the Alienation of State-Owned and Municipal Property.
- ⁴⁷ Article 53 of the Law on the Privatization of State-Owned and Municipal Property.

- ⁴⁸ This issue has not been adequately covered by law. It is anticipated that it will be resolved by drafting amendments to the Law on Alienation of State-Owned and Municipal Property (the procedure for the transfer of real estate) and a new Law on State-Owned and Municipal Companies (the procedure for the transfer of equity shares).
- ⁴⁹ Article 14 of the Law on Local Government.
- ⁵⁰ The above provision has been retained since the mid-nineties. Current legislation has changed. Because the private sector dominates the economy, anyone is eligible to provide services to inhabitants and operate efficiently and profitably; whereas the tariff ceiling for basic services are set by the public utility regulator of the respective municipality.
- ⁵¹ Article 14 of the Law on Local Government.
- ⁵⁴ Article 3 of the Law on Prevention of the Squandering of State and Municipal Assets and Financial Resources.
- ⁵³ The Local Government Financial Equalization Fund was established to account for the fact that local government revenues differ depending on their location, the number of inhabitants and the business environment. The Council of Ministers approves the budget and distribution procedure for the fund, and a subsidy from the central budget is transferred to the equalization fund (usually constituting 20% of the fund's budget).

COUNTRY REPORTS

Jerzy Regulski

Devolution of National Property to Local Government in Poland



FROM USAGE TO OWNERSHIP

Transfer of Public Property to Local Governments in Central Europe

Devolution of National Property to Local Government in Poland

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1. INTRODUCTION

To present the scope and organization of property devolution, an understanding is necessary of the ownership model under the communist regime.

Communist policy was oriented toward the maximization of state ownership. To achieve this, the following classifications were introduced:

- 1) Socialized property, including:
 - state-owned property;
 - cooperative property;
 - property owned by other social organizations;
- 2) Individual property, including private means of production, agricultural land, housing, etc;
- 3) Private property, including all movable items and flats.

State property was administered by:

- ministries and central administrative agencies;
- local or regional state administration;
- state enterprises.

State enterprises were under the control of 'founding organs'—ministries as well as regional or local administrations representing the state. Theoretically, important enterprises were under direct control of the central government and smaller enterprises were under local control. In reality, this principle was not always followed.

Each municipality contained fixed assets belonging to all classifications—state-owned property administered by:

- local administrations;
- regional administrations;
- the central administration;
- state-owned enterprises controlled by local, regional or central bodies;
- housing, agricultural and other cooperative property;
- private property.

The property structure in individual municipalities differed widely, as a result border changes, forced migrations, war casualties and local political pressure following WWII.

All this had to be taken into account in the planning of property devolution after 1990.

2. ESTABLISHMENT OF MUNICIPALITIES

2.1 The Character of Local Government Reform

As a basis for the reestablishment of local government, property devolution supports all other reforms. The first step in the reform process was the establishment of municipalities in 1990. In order to understand the revolutionary nature of these changes, one must keep in mind the system of communist monopolization. There were five types of monopolies:

- 1) *Political monopoly*—political power was concentrated in the communist party, the only party recognized by the Constitution. After the 1990 elections, local councils were composed of members representing various parties and political programs, not subordinated to any single political command center.
- 2) *Uniformity of state power*—divisions or branches of power did not exist, leaving no room for any kind of local autonomy. Reforms weakened the hierarchical structure between local and central authorities. Municipal councils gained importance in public life, with exclusive responsibilities protected by the Constitution.
- 3) *Property and ownership rights*—municipalities became legal entities allowed to own property according to the Civil Code. The state was no longer the sole property owner.
- 4) *Financial monopoly*—local budgets had been controlled by the central government. Reforms gave local governments control over resources of their own. They were allowed to take credit, issue bonds and manage an independent financial policy.
- 5) *Administration*—unified state administration was a pillar of the command structure. On May 27, 1990 nearly a hundred thousand local administrators were moved out from central authorities. Municipal councils received their own executive structures. Reform allowed the implementation of policies independent from the central administration.

2.1.1 *Important Events*

- 1981
In June, at an opposition forum, the first document on restoration of local government in Poland was presented (by the present author and his team). In September, the 1st National Convention of the Solidarity Trade Union passed a resolution containing demands for democratic local government.
In December, declaration of martial law to protect the existing political system stopped all discussion on reforms.
- 1982–1988
Semi-legal research was conducted on the reestablishment of local government.
- 1989
Round table talks between the democratic opposition and communist authorities began in February. A working group on local government signed a protocol outlining the divergent positions of the two parties.
On June 4, the democratic opposition won a victory in the parliamentary election.
In September, the first non-communist prime minister appointed a minister of local government reform.
- 1990
On March 8, Parliament approved changes to the Constitution and passed the Local Government Act. On May 27, the first free municipal elections were held.
- 1998
In June, Parliament passed a law on a three-tier system of local and regional authorities, establishing two upper tiers: *powiat* (district) and *województwo* (voivodship or region).
- 1999
The new system became operational on January 1.

2.2 The Scope of Real Estate Devolution

2.2.1 *Basic Principles*

From the beginning of the process, opposition groups understood the ownership of property and the right to dispose of it freely as one of the main conditions for independent

local governments. The state authorities were ready to introduce municipal property as a new legal category, but opposed systematic reforms. They expressed a readiness to create an instrument of reform, but not to develop an entity that instrument could serve.

The Local Government Act of 1990 gave ownership rights to municipalities, their associations and other municipal entities, including enterprises. According to the act, municipal property could be acquired by transfer of national property or through a municipality's own economic or legal activity. Municipalities were granted full autonomy to dispose of their property, without any specific limitations. Of course, they were subordinated, like all other owners, to restrictions imposed by laws on environmental protection, protection of monuments and agricultural land, etc.

The act did not introduce any limitations on the character of municipal property. Municipalities could acquire any kind of property acknowledged to be useful to their activities.

In practice, the devolution process depended on the context in which the reform was prepared. Two factors had to be taken into account. First, a large number of properties and companies were to be transferred to local governments. The exact number of lots transferred is still not known; estimates are in the millions.

The former administration attempted to resist these changes. Reformers, then, strove to resolve as many issues as possible through exercise of the law, not according to individual decisions. This led to a risk of numerous individual mistakes. Sticking to generally accepted rules created some very complicated situations. In order to resolve these issues, extensive studies were needed, but there was no time for such activity.

The reformers adopted a few simple rules. First, the entire devolution was based on a legislative decision, so municipalities obtained property by law, possibly as a one-time operation. The starting point was a pragmatic assumption that all property managed by the existing local people's councils was to become the property of municipalities.

It was not, however, possible to transfer all council property mechanically. In many cases, local administrations managed buildings housing state offices, church property or structures used by foreign embassies. The central administration needed to retain properties associated with the functions that remained within its scope of authority.

2.2.2 *Exclusions to Devolution*

The law provided numerous exceptions to devolution. Elements of national property did not become municipal property if:

- They were involved in the delivery of public services assigned to the central administration or the courts.
- They belonged to state enterprises or units exercising functions above the local level.
- They belonged to the National Land Fund, an entity that administers arable land owned by the state.
- They were used by diplomatic missions of foreign countries or international institutions.
- They were used by churches or religious organizations.

Many facilities that served individual municipalities were managed by regional administrations. A mechanism was therefore necessary to extend the scope of property subject to devolution. For that reason, the law contained a provision that municipalities were to receive those elements of national property or enterprises which were managed by voivodship (regional) councils, voivodship offices, if that property was necessary to the exercise of municipal duties. The law also provided for the possibility of extending the scope of devolved property, stipulating that a municipality, upon request, could receive national property other than that mentioned in the law, if that property was necessary for the functions associated with the municipality.

2.2.3 *Properties and Rights of Rural Communities*

Within rural and urban municipalities, self-governments were established in villages (*solectwa*) as well as in urban districts (in major cities), *as auxiliary units to municipalities*. These governments also received certain *rights to some* elements of national property. As early as the Middle Ages, royal charters had granted various privileges to certain localities. The best-known privilege is the right of one village, now a borough of Krakow, to graze cows in green spaces located in the center of the city. This privilege is still respected.

The provisions of the laws of 1990 were clear. Municipalities were recognized as the primary units of local government and were granted exclusive ownership rights. As a result, *solectwa* and rural communities also claimed rights. It was therefore decided that auxiliary units could use and manage municipal properties according to the terms and conditions defined in municipal council by-laws, but the councils could not reduce the existing rights of those units. That meant that although municipalities had taken over national property, they were obliged to hand over some property to the *solectwa*. The growing independence of *solectwa* progressed, leading to further extensions of their rights to municipal property.

2.2.4 *Housing*

In 1990, four categories of housing estates existed in Poland:

- communal;
- co-operative;
- those belonging to state enterprises;
- private.

Only communal housing estates that previously belonged to the state were devolved to municipalities. The quality of those estates differed widely, from housing built in recent decades to old buildings from the pre-war period which had been nationalized. Housing was often in a poor condition and in need of repairs.

The housing sector was an important area that required appropriate legislative standards. In the past, housing had not been regarded as a commodity but as something the state was obliged to provide. Regulations remained from the time of 'class struggle' which limited rights to larger flats, as well as limiting citizens' right to generate income from such property. New solutions were necessary, but every proposal led to conflicts of interest. All parties that benefited from the existing situation were interested in maintaining it. In 1990, municipalities received housing resources from the state. The administration of those resources became a serious problem, which must be discussed separately.

2.3 Organization and Management of Property Devolution

2.3.1 *Office of the Minister of Local Government Reform*

All preparation and implementation of local government reform and its implementation was under the responsibility of the minister of local government reform, a position known as *pelnomocnik rzadu* in Poland—a 'government plenipotentiary.' The office carries the rank of an undersecretary of state, authorized by the council of ministers to perform specific tasks which encroach on the responsibilities of several ministers. The government plenipotentiary reports directly to the prime minister and can act on his behalf.

This office was included within the structure of the *Office of the Council of Ministers* and employed a dozen people, all highly qualified experts. As new acts passed and implementation of the new system progressed, the department took control of the offices of regional people's councils in all 49 regions, employing 3 to 5 people in each. The minister

appointed regional delegates, mainly former opposition members who supported reform. They served as the deputy heads of regional administration and were given a large autonomy. They were completed all preparation work for reform within their assigned region and supervised implementation. After elections, they assisted the newly established local authorities. They disseminated regulations, directives, organized training and gave advice. They also represented local interests to the state administration, extremely important in the process of property devolution. Without this activity, the new and inexperienced governments would not have been able to influence the strong state administration.

2.3.2 *Procedures*

Property devolution was to affect a huge amount of national property scattered all over the country, fragmented into millions of elements. It was therefore necessary to establish a decentralized system, capable of conducting countless operations in a relatively short time. The system was expected to be flexible in resolving unpredicted difficulties in specific cases while simultaneously ensuring that uniform decisions were made on the national scale. Municipalities were obliged to inventory the property they managed and present proposals for ownership to regional state officers. These materials were to be publicly available so that all citizens and institutions could present claims and reservations. The devolution of property, being a change of ownership, could not interfere in the rights of tenants or other users of property. Public access to all documents was particularly important, as many people had been expropriated of their property in the past and now had a chance for restitution.

The voivod (regional officer), representing the state, issued decisions on the transfer of properties to the municipality, confirming the municipal acquisition of property according to the law. This was a basis for entry into the land registry and transfer of the property by the local government. If, however, the voivod had objections, he/she could refuse to make such a decision and the property remained in the hands of the state. In such a situation, a municipality could submit an appeal to the National Enfranchisement Commission, an authority appointed by the prime minister. Both parties were entitled to submit an appeal against the commission's decision to the Supreme Court.

As legal entities, municipalities received the right to present claims against the central administration to the general courts, as described in the Civil Code.

A similar procedure was applied to property transferred to municipalities upon their request. A municipality was also an applicant, and the voivod represented the state. In that

case, the transfer of property was based on agreement, not law. The voivod, therefore, did not have to transfer the property, but could do so if it was justified.

2.3.3 *The National Enfranchisement Commission*

Hundreds of thousands, even millions of decisions were issued by virtue of law to devolve properties to local governments. Several thousand appeals were filed with the National Enfranchisement Commission.

The establishment of the commission was a specific solution, which made the process of property devolution credible and fully democratic. Local authorities were treated as equals to the central administration. The powers of the commission were defined by law. Teams of three made decisions, but the whole commission examined particularly important matters. The composition of the commission changed several times. There were more staff members when the number of applications ranged from 1.4 thousand in 1991 to nearly 2 thousand in 1992. In following years, when the number of applications decreased, the commission's staff was reduced. The commission completed its work in seven years.

The reasons for appeal varied. Municipalities appealed when they disagreed with the voivod on a given property. Other institutions and private individuals filed protests. The National Enfranchisement Commission allowed a broad definition of the terms of appeal and stated that not only a municipality or voivod were included in the procedure, but also anyone whose interest could be violated by the process of devolution. The idea was that this process was to clean up and clarify the system of ownership in Poland. Hence, appeals made by individuals were also reviewed. In many cases their concerns were unjustified, because transfer of property did not infringe upon users' rights.

The rulings in this respect are clear: land was subject to devolution if it was owned by the national treasury on May 27, 1990. However, buildings erected by users remained their property, and they obtained the right to long-term lease.

2.3.4 *Issues and Legal Decisions*

Although legal provisions were clearly defined, many conflicts occurred; some only to be resolved by resolution of the constitutional tribunal. Some of most important issues were as follows:

- 1) *Indivisible property*: In many cases properties were used jointly or were subdivided by local and other institu-

tions. Usually it was impossible to divide buildings or lots. The tribunal decided that in such situations real estate was by virtue of law co-owned in proportion to functions exercised. It was then up to the co-owners to decide upon future use or separation.

- 2) *Location of a property*: In many cases municipalities or their enterprises administered national property situated outside their boundaries. Water intakes, sewage treatment stations, refuse dumps or recreational facilities were in such a situation. Thus a question emerged if the property should be transferred to the municipality in whose territory the property is located, or to the one whose authorities actually manage it. The constitutional tribunal's unequivocal ruling was that the location, not the administration, determined the right of ownership of a municipal property.
- 3) *State agricultural land*: If separate plots constituted economically justified wholes, they were transferred to state farms. The National Land Fund kept, however, scattered fragments of land that could not be leased or attached to existing farms. The question was whether that land should be transferred to municipalities, which would certainly put it to the best use, or left in the hands of the central administration. A compromise was made, where municipalities obtained the right to apply for ownership of specific plots of land.
- 4) *Natural resources*: The recognition of the municipal right to own land enforced the definition of their entitlement to natural resources under the surface. This issue was resolved later in a law adopted in 1994. It was necessary to reconcile national interests with the interests of local communities directly exposed to the effects of geological and mining activity. The state maintained ownership of minerals—the right to use them and supervise excavations. But the opinion of local government must be taken into account in the process of issuing licenses for the search and identification of deposits and for the excavation of minerals. Sixty percent of the income from charges for excavation and mining belong to local budgets and forty percent go to the National Environmental Protection and Water Management Fund.
- 5) *Unused property of state enterprises*: A municipality should always reserve some land for future development. However, substantial land resources were under administration of state-owned enterprises, which usually demanded more land than they needed. After all, land did not cost anything. Reformers intended that the so-called reserve resources be transferred to municipalities and not be frozen in the hands of enterprises. For that reason the law contained a provision according to which land owned by state-owned enterprises but not used

according to its purpose should be transferred to municipalities upon their request.

The industrial lobby managed to change the laws and on December 9, 1990 state enterprises became owners of the land they managed. This was considered entirely inappropriate by reformers. In many cases nearly bankrupt state-owned enterprises covered their deficits by selling land instead of restructuring.

This raised the question of partial property transfers from state-owned enterprises to a municipality. Some enterprises wanted to alienate various unnecessary property elements that were of municipal interest. The view that prevailed, finally, was that as the state treasury no longer owns the property of a state enterprise, the Law on Property Devolution was inapplicable.

- 6) *Unwanted property*: Besides conflicts around the take-over of wealth, there were many instances of unwanted property. Local governments often argued that they did not agree to take over a property with debts attached, as the debts had arisen when the property was owned by another party. The National Enfranchisement Commission did not accept these arguments, claiming that the law not only gave the right to take over properties, but also defined an obligation to hand over property to municipalities which was necessary for their functioning. Local governments were obliged to take over the entire property, both assets and liabilities. The transfer of a property and other proprietary rights is obligatory. In practice, it means a municipality may not 'choose' a certain part of the property, as that would contradict the legal duty of exercising its functions.
- 7) *Claims for properties administered by regional administration*: Besides wealth transferred by law, municipalities could obtain, by request, an element of property administered by a regional administration, if it is necessary for the exercise of their functions. Many such applications were submitted to the state administration in that respect. The primary aspects taken into consideration were the relations between the claimed property and the municipal functions and regulations set-aside in the land use plan. Decisions on municipal claims were always very difficult and required a number of studies and expert analyses.

The most spectacular conflict, lasting many years, grew around the right to land used as allotments (so called 'workers gardens'). Allotments are very popular in Poland. A law forming the Polish Association of Allotment Users, adopted in 1981, provided that national land could be used free of charge for that purpose. Then, according to laws passed in

1990, that land, being national property, should have been transferred to municipalities. The association and its regional boards made claims for the land. However, the National Enfranchisement Commission and the Supreme Court stated consistently that land used for allotments had become municipal property by virtue of law. The political allies of the association managed to pressure Parliament into a passing a new law on allotment privileges. When the constitutional tribunal declared the law unconstitutional, Parliament overruled this verdict. Owing to that law, the Polish Association of Allotment Users became the biggest urban landowner in Poland. The association received the right to long term use of 420 km² of land free of charge. In central Warsaw alone, according to market prices, the allotments were worth 2 billion dollars.

2.3.5 *Municipal Companies*

The decision that municipalities take over the property of the former people's councils enforced a transfer of all state enterprises that had been under control of former local administration. Many questioned whether the transfer of all enterprises to municipalities was appropriate. The question was important, as in the late 1980s the communist authorities began to implement a policy of deconcentration of management. Without changing the principles of the system, management of more and more state-owned enterprises was transferred to regional or local authorities. The process advanced to varying degrees in individual parts of the country.

There were three categories of the state enterprises under local control:

- enterprises that deliver of public services;
- enterprises that maintain municipal estates;
- profit-oriented units.

All enterprises delivering public services went to municipalities. There were no difficulties in transferring an enterprise administered by a municipality and serving only its inhabitants. They were transferred by law with all their assets. In several cases an enterprise under the control of a municipality served neighboring units as well. In such situations, the enterprise went to the municipality in which it was located and future cooperation was to the free agreement between interested municipalities.

There was not enough time for adequate in-depth studies of state enterprises serving individual municipalities but administered by central or regional administrations. Such cases were expected to be analyzed individually. In effect, the resistance of state administration was so strong that not one enterprise was transferred in subsequent years and a sub-

stantial number of locally important enterprises were excluded from devolution to municipalities. The process of property devolution was assumed to enjoy general support. That support, however, did not materialize.

2.3.6 *Associations Serving Groups of Municipalities*

Due to the specific type of functions assigned to public utilities, some organizational units provide services to an area which considerably exceeds the territory of one municipality. Hence, there were many enterprises running local services but subordinate to regional authorities. According to laws adopted in 1990, their property was to be transferred to municipalities. Two procedures were possible in that case: enterprises could be divided and their individual parts transferred to appropriate municipalities, or if the property was indivisible it could be handed over to associations formed by interested municipalities. Until that time, the enterprises and their wealth were to remain under the management of the regional administration.

The law stated that municipalities might establish task-oriented associations to deliver specific public services assigned to individual municipalities. An association may possess property as a legal entity. The ministry of the interior keeps a registry of associations, which allows the monitoring of their formation. The registry does not include agreements between municipalities if a separate legal entity is established.

The establishment of an association is a voluntary decision; it is not a simple process. All interested local governments have to make identical decisions, so initial negotiations are always long and difficult. However, Parliament may oblige municipalities to form a task-oriented association in order to exercise specific functions. But such decisions are very restricted in number. The first task-oriented association of municipalities was registered on October 6, 1990. The next were formed soon afterwards. The largest number of associations was registered in 1991, decreasing afterward. Functions requiring joint efforts had clearly been exhausted. The associations are very different in terms number of member municipalities. 40% are rather small, with up to 5 members, and 22% are large associations with more than 10 members.

However, in many cases municipalities were very cautious in creating associations to take over service delivery enterprises of regional character. It was risky and expensive. As a result such associations were never established in some urban agglomerations where individual enterprises delivered services for several cities. Enterprises were under state

administration for several years, until the reforms of 1998 established district and regional self-governments.

2.3.7 Municipal Roles and Policies in Service Delivery and Economic Activity

The transformations in the public service sector were the subject of stormy debates. Disputes focused on the basic issue of what a municipality is supposed to be in the economic sense, and consequently, what methods it should use to exercise its legal functions. The 'liberals' claimed local government should only represent residents' interests and confine their activity to strictly administrative functions; consequently they held that municipal property should be radically privatized. They were afraid municipalities could create local monopolies and restrict the development of the private economy. Local government 'advocates' were of a different opinion. They believed a municipality had obligations with respect to its residents which it may fulfill only if it has its own property and conducts economic activity, not only municipal, but also commercial. Therefore they opposed privatization of municipal property and strove to establish direct management of public utilities.

As was mentioned before, local administration controlled many enterprises not linked to public service delivery. It was impossible to establish, in a short time, clear criteria for their devolution to municipalities. Thus, we chose the simplest solution. The Council of Ministers was authorized to issue a relevant executive order excluding certain enterprises from devolution. 69 enterprises, including 42 in agriculture, were to remain state-owned; some thousand of state enterprises were transferred. Many of them were clearly linked to municipal economies, such as enterprises for housing maintenance, green spaces, etc. Many others were purely profit-oriented.

Municipalities took over not only properties of public utility, associated with their own functions, but also property owned by commercial enterprises and buildings used for housing purposes. Consequently municipalities were engaged in economic activity beyond the sphere of public utility. The law of 1990 gave them this right, if it was justified with social needs. Municipalities could form organizational units, including enterprises, and conclude agreements with other entities. The purpose of this legislative flexibility at the beginning of systemic transformations was to enable municipalities to play the role of a specific catalyst for economic change. Municipalities were particularly predestined to perform that task, as they represented forces contrary to the earlier totalitarianism.

The activities of local governments were quickly revealed in the effects of the market economy. The so-called 'small-

scale' privatization of trade and services became almost symbolic as it introduced a new reality into the recent past. That caused a principal debate on the right of local government to perform economic activity. Several stormy discussions were held in Parliament, outlining two clear options.

According to an idea effective in many countries, local governments may not be involved in economic activity outside public utility. Municipal revenues should come from taxes. Local government should support economic development by creating conditions for private enterprise. Involving local government in profit could lead to monopolist measures.

Another option grew out of the current situation. Polish municipalities had been involved in economic activity earlier and were owners of many enterprises. The exclusion of these enterprises from devolution would lead to state control over the economy, contradicting the objectives of transformation policy. One way to break state monopoly was to devolve enterprises to municipalities, then gradually privatize them. At that time, insufficient supply appeared to reduce the danger of local monopolies. Therefore in 1990 municipalities received several profit-oriented enterprises.

During subsequent years this approach changed several times, and legislation was changed as well. Finally, municipalities have the right to engage in economic activities, but restricted to their public responsibilities

2.3.8 Legal Status of Municipal Enterprises

Under the previous system, state enterprises were charged with the delivery of public services. According to the Law on State-Owned Enterprises, the authorities of the enterprise (mainly the employee council) had a number of powers to which an owner is entitled according to civil law. A special threat lay in the absence of efficiency incentives—very dangerous in monopolies.

The Local Government Act of March 8, 1990, which defined the scope of municipal responsibilities in public service delivery, gave local governments freedom to choose the manner of service provision. According to that act, local governments may either provide services directly, create organizational units, including enterprises, or conclude contracts with other entities. The choice had to be harmonized with the legal status and structure of enterprises devolved to municipalities. The ownership and legal statuses of enterprises was in flux. For that reason, the laws obliged local governments to make the following necessary legal transformations:

- transformation of a state-owned enterprise into a company, according to the Civil Code;

- direct delivery of services by the municipality or municipal establishments;
- contracting services to other entities according to civil law and privatization, or liquidation of enterprises taken over.

Companies are separate legal entities—they act on their own behalf and bear risk themselves. The municipality is not liable for their obligations and companies are not responsible for the obligations of the municipality. The municipality, being the owner or co-owner of a company acts according to principles defined by law.

Local budgetary establishment is based on the provisions of the Budget Law and is not a legal entity. The municipal council founds the establishment, which transfers financial surpluses to and receives subsidies from the municipal budget. The municipality is thus fully responsible for the obligations of the budgetary establishment. All capital expenditures are financed by the municipal budget.

The law allowed local governments to conclude contracts for services with individuals or other enterprises. This particular provision is of fundamental importance to the introduction of market mechanisms into the municipal sector. In such an arrangement, the local government withdraws from direct activity on the municipal service market, but that does not mean it is not responsible for quality of services. The Law on Public Procurement defines the principles of such contracts.

The process of legal transformation was long and difficult. Municipalities were afraid to make sometimes revolutionary changes, and managers and employees were generally resistant to any changes. Finally, Parliament was obliged to issue a law fixing a date after which all former state enterprises in municipal hands became companies, subordinate to the Civil Code. The progress of the transformation process was not identical in all municipal sectors; it depended on the specific features of a given sector. In areas where service delivery relied on expensive infrastructure, or official prices were applied, transformations encountered serious difficulties. On the other hand, the market for services in which private firms had an increasing share was developed in those areas which did not require any extensive technical infrastructure and where prices are flexible.

The entire public service delivery sector, however, evolved toward a market economy model. The former model of state enterprises disappeared completely. In many municipalities, former enterprises were cancelled or privatized, and service delivery was contracted to private companies. Recently, some municipal companies were transformed into joint-stock companies and traded in the Warsaw Stock Exchange.

3. ESTABLISHMENT OF DISTRICTS AND REGIONS IN 1998

The second step in strengthening decentralization was the establishment of two higher tiers of local and regional government. The process of transformation of the state was continued throughout the decade. The transfer of primary schools to the municipalities was the greatest change in property management. Real estate and all movable assets belonging to schools became municipal property.

The positive experiences associated with the transfer of property to municipalities established a model for reforms in 1998. Both districts and regions were granted legal status and ownership rights and received certain state properties. The scope of property devolution was much more limited, and transfer was much simpler. Districts took over several institutions, which had been controlled by the middle level of state administration. Property was transferred together with administrative responsibilities. Despite the fact that districts took ownership of 6,155 units, the transfer was quick and easy. Regions took over the property of 1,323 units. However, the management of property is of marginal importance to regions, as they concentrate their efforts on supporting economic development.

Table 4.1

Number of Organizational Units
Taken Over by Districts and Regions

Sector	Units Transferred to Districts	Units Transferred to Regions
Education	4,207	445
Health care	477	476
Public welfare	718	0
Culture	166	201
Other	587	201
Total	6,155	1,323

The extent of these transformations called for a special organization. The Council of Ministers established a special ministerial team led by the Minister of the Interior, which was given extensive powers of attorney. The team was composed of representatives of all interested ministries. Its secretary, deputy minister of the interior, by special appointment, coordinated the entire work of the team. The implementation of all transformations was assigned to voivods in 16 new regions. The voivods were supervised by plenipotentiaries appointed in each new voivodship. Deputies from interested ministries were assigned the role. Their supervision was

generally confined to intervention in crisis situations and the actual burden of performing the task fell on the voivodship administration.

4. CONCLUSIONS AND EVALUATION

Devolution of state property to municipalities was the first, perhaps the only one-time operation on such a scale to reduce national property in Poland. Results were positive because the operation was conducted in a comprehensive and radical manner. The principle of transfer by law, as well as the organization of a system for negotiations and appeals limited biased decision, although they could not be entirely eliminated. The results are easy to see when traveling across Poland: the improving conditions of previously neglected villages and towns and the visible effects of owners' greater care for tidiness and order.

4.1 A Success: Infrastructure and Environmental Quality

The most spectacular effects are to be seen in the field of local infrastructure. The infrastructure inherited by the new local authorities were frequently in an awful state of disrepair, making residents' lives difficult and restraining opportunities for economic development. Infrastructure development became a municipal priority. The previous bureaucratic system of investment and development was eliminated and

a new system was launched, based on market mechanisms. Sensational results were achieved. Table 4.2 shows the development of sewage and water supply systems. The great improvements were the result of work performed by municipalities, owners of more than 90% of water and sewage facilities.

It should be noted that the quality of the infrastructure improved. This can be observed especially in sewage treatment plants. Cities now demand a higher standard for those plants, replacing mechanical plants with modern technology.

Road construction was another objective. Local governments spent nearly 1.6 times more on this than they generated from vehicle tax, which was the source of income allocated for the extension of roads. From 1993 to 1999, the length of paved local roads increased by 15%.

The activity of rural municipalities deserves particular emphasis here. The economic structure in communist Poland gave definite priority to industrialized areas causing the impoverishment and stagnation of agricultural areas. In the situation following 1989, rural municipalities were considerably handicapped by poor infrastructure, the lack of capital and shortage of technical staff and skills necessary to organize public works. Even so, results exceeded all expectations. The number of houses connected to water systems in rural areas in 1990-1998 increased from 400 thousand to over 2 million. The increase in connections to sewage systems was also considerable—530%. In 1999, 71.7% farms were connected to water systems, up from 29% in 1990. This means a substantial change of living standards in rural areas.

Table 4.2
Water Supply and Sewage Systems in Poland

Specification	1980	1990	1999	Changes		
				1980-1990 (2)-(1)	1990-1999 (3)-(2)	Between Decades [%] (5) : (4)
	(1)	(2)	(3)	(4)	(5)	(6)
Water systems:						
Water-main [thousand km]	6.1	8.3	41.8	2.2	33.5	1,522
Distribution system [thousand km]	53.1	93.1	203.6	40.0	110.5	276
Connections to houses [thousands]	1,203	1,531	3,723	328	2,192	668
Sewerage systems:						
Sewers [thousand km]	20.5	23.1	46.8	2.6	23.7	911
Connections to houses [thousands]	460	511	1035	51	524	1,027
Cities served by sewage treatment plants:	357	467	778	110	311	282
Mechanical	158	165	67	7	-98	
Biological-standard	199	302	666	103	364	
Biological-upgraded	0	0	205	0	205	

Attention should also be paid to the development of telephone connections in rural areas. Regarding the relation between the number of telephone users to the entire population, Poland was at the bottom of the list of European countries in 1990. Owing to the activity of local governments, however, considerable success was accomplished. The number of telephone users grew exponentially. Mobile phone networks expanded exponentially as well.

Table 4.3
Users of Fixed-line Phones

Users [Thousands]	1980	1990	1999
In cities	1,727	2,902	7,872
In rural areas	216	391	2,204
Total	1,943	3,293	10,076

These changes influenced the quality of life and had an important impact on environmental quality. Water supply systems and treatment plants had a crucial impact in that field, as municipalities received the power to intervene against air pollution. In the past, the state administration was very lax with respect to all industrial polluters due to informal political pressures. This is not the case when local governments are supported by suffering local population.

4.2 Financing Development

Funds used to finance the development of infrastructure came from many different sources. Besides local budgets, grants from the central budget and residents' own contributions, the biggest sources were the National Environmental Pro-

tection and Water Management Fund and voivodship environmental protection funds as well as the Agency for Agricultural Restructuring and Modernization. The latter has been the administrator of the government's 300 million-dollar loan from the World Bank since 1994, of which 250 million were set aside for rural development.

It is striking that municipal budgets had such a big share in individual investments—about 50%—and the constant increase of capital expenditures clearly exceeds the inflation rate. This example shows the huge capacity of local governments to generating funds from different sources.

4.3 A Failure: Regression in Cultural Institutions

Municipal economy and management were successful. But some areas experienced regression—mostly in culture. Regression in this area is the result of two factors. On one hand, the shortage of funds; on the other, lack of vision in supporting culture under the new systemic conditions. Hence, there is a lack of policy in this field both at the local and central levels.

Reforms implemented after 1990 resulted in the decentralization of decisions relating to culture as well as funds used to support culture. The transfer of powers and funds to local governments was to enable the adjustment of cultural infrastructure and activities to local needs, as the management of cultural development is local government's inalienable attribute. But there was no program on how to do it. The development of such a program was beyond the capacity of local activists. Local governments, without models, did not know how to adequately support culture. Because their budgets were insufficient, they cut expenditures in that field.

Table 4.4
The Structure of Capital Expenditures on Water and Sewage Systems by Sources of Funding

Source of Funding [%]	Water Supply		Sewerage Systems	
	1993	1999	1993	1999
Municipal budgets	59.4	59.4	51.7	47.4
State budget	17.3	8.2	6.1	6.2
Residents	17.8	14.8	3.4	4.5
NEPWMF	5.5	3.7	38.1	26.9
AARM	—	8.2	—	7.5
Other	—	5.7	0.7	7.5

Table 4.5
Changes in the Number of Cultural Institutions
from 1990 to 1999

Type	1990/91	1999
Civic and cultural centers	2,343	2,241
Clubs and activity centers	1,759	1,344
Museums	563	623
Cinemas	1,318	682
Public libraries	10,269	9,046
Community libraries	17,565	2,870
Artistic groups	12,091	14,848

4.4 SECONDARY EFFECTS

There were also less visible but equally important effects. When municipalities began to experience the right to ownership, they began to lease buildings at market prices. This caused completely unexpected secondary results. One was

the break with the old system of retail sales. In the communist system, retail trade was largely nationalized, with big national enterprises—in effect, oases of party *nomenklatura*. These enterprises had numerous privileges, such as reduced rent for facilities. These monopolies of state retail trade fell apart only when municipalities had taken over buildings and began to treat tenants equally. State-owned enterprises were not able to pay as much rent as private tenants.

Devolution of state property became one of the fundamental elements of the tremendous breakthrough that was municipal reform. Possession of property was a basis for local dynamic activity.

The Polish experience provides evidence that transfer of state property to local governments is a fundamental condition for effective decentralization. Without unrestricted ownership and asset management rights, local governments would be unable to act effectively.

The entire devolution process must be done radically but very flexibly, as local conditions differ, and it is impossible to foresee all issues which will arise. The way in which devolution is organized and implemented has a decisive impact on the final result.

ANNEX 1

Extract from the Law on Municipal Self-government
passed March 8, 1990*Definition of Terms*

Gmina—a municipality, the smallest administrative unit in Poland. There are about 2500 *gminas*. They were formed into self-governing bodies in 1990.

Województwo (voivodship)—region, existed in 1990 within a two-tier system. In 1999, the three-tier system was introduced and the number of *województwos* was limited to 16.

Wojewoda (voivod)—head of state administration in a *województwo*.

Sołectwo—a rural community, an auxiliary unit to a *gmina*, not a legal entity.

Chapter 5

Municipal Property

Article 43.

Municipal property shall include ownership and other rights to property held by individual *gminas* and their associations and the property of other municipal legal entities, including companies.

Article 44.

Municipal property shall be acquired pursuant to the law—implementing laws to the Local Government Act—by way of transfer of property to *gminas* in conjunction with the establishment or change of the *gmina's* boundaries according to the procedure referred to in Article 4; property shall be transferred by way of agreement of interested *gminas* and in the absence of agreement, pursuant to the decision of the prime minister, as a result of conveyance by the central administration on terms defined by the Council of Ministers by way of executive order, as a result of own business activity, by way of other legal transactions or in other cases defined in separate provisions.

Article 45.

Entities which hold municipal property shall make independent decisions on the purpose and use of elements of prop-

erty in compliance with the requirements contained in other legal provisions, the provisions of Paragraph 2 excepted.

A *gmina* council's resolution shall require approval by the voivodship assembly if the voivod lodges an objection by way of resolution if the resolution concerns: (i) changing the purpose and alienation of property which serves public benefit or direct satisfaction of public needs, (ii) changing the purpose and alienation of objects which have a particular scientific, historical or environmental value, (iii) alienation of other elements of municipal property with no compensation.

Article 46.

A declaration of will on management of property shall be made on behalf of the *gmina* by two members of the executive board, or one member of the executive board and a person authorized by the board (plenipotentiary), unless the bylaws provide otherwise.

The executive board may authorize a rural mayor (*wójt*), or city mayor (*burmistrz*) to make a declaration of will associated with the management of the *gmina's* everyday affairs.

If a legal transaction may result in financial obligations, the *gmina* treasurer (chief accountant for the budget) or another person authorized by the former shall be required to countersign it for the transaction to be effective.

A *gmina* treasurer (chief accountant for the budget) who refuses to countersign it, shall do it upon written instruction from a superior and shall notify the *gmina* council and the regional audit chamber thereof.

Article 47.

Heads of *gmina* organizational units, which are not legal entities, shall act as single persons based on authorization granted by the *gmina* executive board.

The executive board's approval shall be required for transactions which exceed the scope of the authorization.

Article 48.

The rural community or urban district shall manage and use municipal property and use revenues from this source to the extent defined in the bylaws. The bylaws shall define also the scope of legal transactions made independently by

the authorities of the rural community or urban district with respect to the property to which they are entitled.

The *gmina* council may not reduce the rural community's (*solectwa*) present right to use the property without the consent of the rural assembly.

All rights of ownership, usufruct, or other rights to assets and property, hereinafter referred to as municipal property, held hitherto by rural residents, shall remain inviolable.

Provisions on municipal property shall apply to *gmina* property, Paragraph 3 excepted.

Article 49.

The *gmina* shall not be liable for the obligations of other *gmina* legal entities, and the latter shall not be liable for the *gmina's* obligations.

In the event of abolishment or division of a *gmina*, the *gminas* which take over its property shall be jointly liable for its obligations.

Article 50.

Persons involved in the management of municipal property shall be obliged to ensure special diligence when exercising management according to the purpose of this property and to protect it.

ANNEX 2

Extract from the Law on Implementation of Laws on Local Self-government and Self-government Employees, passed May 10, 1990

Chapter 2

Acquisition of Municipal Property

Article 5

1. If further provisions do not provide otherwise, national (state) property, which belongs to:
 - (i) national councils and local authorities of the state administration at the primary level,
 - (ii) state-owned enterprises for which the authorities referred to in Point 1) are founding authorities,
 - (iii) boards and other organizational units subordinate to the authorities defined in Point 1,
 shall by virtue of law become the property of appropriate *gminas* on the day on which this law takes effect.
2. If further provisions do not provide otherwise, national (state) property, which serves public benefits and belongs to
 - (i) national councils of the capital city of Warsaw, city of Krakow and city of Łódź, and to local authorities of the state administration at the voivodship level in these urban voivodships,
 - (ii) state-owned enterprises for which the authorities defined in Point (i) are founding authorities,
 - (iii) boards and other organizational units subordinate to the authorities defined in Point (i), shall by virtue of law become the property of these cities on the day on which this law takes effect, if it is situated within their administrative limits, unless a special provision provides otherwise.
3. If further provisions do not provide otherwise, national (state) property which serves public benefit and belongs on the day on which this law takes effect to:
 - (i) national councils and local authorities of the state administration at the voivodship level,
 - (ii) state-owned enterprises for which the authorities defined in Point (i) are founding authorities,
 - (iii) boards and other organizational units subordinate to the authorities defined in Point (i),

(iv) *gminas* and associations of *gminas*, if it is necessary for the performance of their functions.

4. Also national (state) property other than that mentioned in Paragraphs 1-3 may be transferred to the *gmina* upon its request if it is associated with the performance of its functions.

Article 6

1. Indivisible elements of municipal property, referred to in Article 5, Paragraphs 1–3, which are used to perform the functions of more than one *gmina*, shall remain, until an appropriate municipal association is established or agreement concluded, managed by the present entities.
2. If *gminas* do not take over the property referred to in Paragraph 1, within one year from the day the Local Government Act takes effect, the voivod shall request the court to designate an administrator. Provisions of the Civil Code shall be applied accordingly to the administration of common property.

Article 7

1. *Gmina* property, as construed under the provision referred to in Article 2, Paragraph 1, Point 1, shall become by law the property of the *gmina* in whose territory it is situated on the day on which the Local Government Act takes effect.
2. The provision of Paragraph 1 shall not violate the rights of third parties to the property mentioned in this provision, including also the rights of land and forest communities.
3. Appropriate authorities shall transfer elements of municipal property referred to in Paragraph 1 to rural communities (*sołectwa*) established in the territory of the existing rural communities, which used *gmina* property. This refers to elements of property situated outside the territory of the *gmina* in which the rural community is located.

Article 8

1. State-owned enterprises for which the founding authorities are local authorities of the state administration defined in Article 5, Paragraphs 1–3, shall remain legal entities, as they become municipal companies.
2. By December 31, 1991 the *gmina* council shall make a decision concerning the choice of the legal and organizational form for its business activity conducted so far by municipal companies. Until the legal and organizational form is chosen, provisions on state-owned enterprises shall be applied accordingly to municipal companies.
3. The Council of Ministers may define, by way of executive order, a special procedure for the division of state-owned enterprises, mentioned in Article 5, Paragraph 3, the division of which is necessary in conjunction with the transfer of municipal property to *gminas* or their associations.

Article 9

1. The rights and duties of entities mentioned in Article 5 shall be transferred to their counterpart municipal entities. This refers in particular to the rights and duties resulting from perpetual usufruct.

Article 10

The transfer of property to *gminas*, referred to in Article 5, Paragraphs 1 and 2, does not violate the right to use elements of property on the existing terms by foreign companies operating in Poland

Article 11

1. Elements of national (state) property, referred to in Article 5, Paragraphs 1–3, shall not become municipal property if:
 - (i) they serve public functions which fall within the competence of the central administration, courts, and state authorities,
 - (ii) they belong to state-owned enterprises, or organizational units which exercise functions at the national level, or above the voivodship level, the provision of Article 14 excepted,
 - (iii) they belong to the National Land Fund, the provision of Article 14 excepted.
2. The Council of Ministers shall define, by way of executive order, a list of enterprises and units, referred to in Paragraph 1, Point 2.

Article 12

National (state) property shall not be subject to enfranchisement, if it is used by:

- (i) diplomatic missions and consular offices of foreign countries as well as international institutions which enjoy diplomatic or consular immunity to the extent to which it results from laws, international agreements or commonly-respected international customs,
- (ii) the Catholic Church or other churches and religious associations.

Article 13

1. Real estate transferred to *gminas* according to the procedure defined in this law shall be subject to regulatory proceedings referred to in Articles 61–63 of the Law of May 17, 1989 on Relations between the State and the Catholic Church in the Polish People's Republic (Journal of Laws, No. 29, item 154).
2. The provision of Article 61, Paragraph 4, Point 3 of the law referred to in Paragraph 1 shall not be applied.

Article 14

1. The land of state-owned enterprises which is not subject to municipalization based on this law and not used according to the socio-economic purpose of this land, shall be handed over, upon *gminas'* application submitted by December 31, 1991, to the *gminas* in whose territory this land is situated.

Article 15

1. Upon a *gmina's* request, land owned by the State Land Fund, situated in the territory of this *gmina*, may be transferred to this *gmina*. Provisions of Article 17, Paragraphs 1, 2, 4, 6 and 7 shall apply accordingly.

Article 16

1. Property shall be acquired based on this law with no compensation.
2. If, pursuant to a special law passed December 31, 1990, there will be a change in the functions and responsibilities of the public administration which will require elements of municipal property acquired pursuant to this act to be transferred to the state treasury, it will be transferred with no compensation, the state treasury paying the cost borne by the *gmina*, according to Article 226, § 1 of the Civil Code.

Article 17

1. *Gminas* shall make inventories of the property referred to in Article 5, Paragraphs 1 and 2.
2. The inventories referred to in Paragraph 1 shall be made by inventory commissions within three months after the *gmina* council appoints the commission.
3. Property other than that mentioned in Paragraph 1 shall be taken over based on records of transfer which reveal also the rights and obligations.
4. Inventories of property and copies of records of transfer shall be available for public inquiry in the seat of the *gmina* management for 30 days about which the public shall be informed in a manner generally accepted in a given area.
5. An individual whose legal interest concerns findings in the inventory of property may, within the time limit referred to in Paragraph 4, present his reservations to the inventory commission.
6. The inventory commission shall review the reservations immediately and, if they are taken into consideration, shall change the findings in the inventory accordingly.
7. The Council of Ministers shall define the method of making the inventory referred to in Paragraph 1.

Article 18

1. The voivod shall make decisions concerning the acquisition of property by virtue of law and decisions concerning transfer of property to the extent defined in the law.
2. The National Enfranchisement Commission shall be established as a body receiving appeals against decisions referred to in Paragraph 1.
3. The Prime Minister shall appoint the chair and members of the National Enfranchisement Commission and shall define the procedure for its work.

4. The provisions of the Administrative Proceedings Code shall apply accordingly to proceedings in cases referred to in Paragraphs 1 and 2, as well as in cases of appeals against decisions filed with an administrative court.

Article 19

Civil law claims associated with the acquisition of municipal property may be vindicated in a common court.

Article 20

1. A final and valid decision confirming the acquisition of property by virtue of law, or concerning transfer thereof, shall constitute a basis for an entry in the land and mortgage register.
2. The final and valid decision, referred to in Paragraph 1, shall be sent within 30 days from the date on which it became final and valid to the appropriate notary's office.
3. Proceedings concerning the entry referred to in Paragraph 1 shall be exempt from court fees.

Article 21

1. If an element of property which is subject to enfranchisement in accordance with the procedure defined in this law was previously contributed as the founding capital of a commercial law company, or cooperative, the *gmina*, or another municipal legal entity may, within three months from the day on which this element of property was acquired, demand dissolution of the company by the court or withdraw its shares from the cooperative, if this element of property is to be used to satisfy the public needs of the local community or if the further operation of the company or the municipal legal entity's participation in the cooperative violates the provisions of the Local Government Act.
2. The provision of Paragraph 1 shall not apply to companies in which foreign entities have shares.

COUNTRY REPORTS

Rafal Stanek

Decentralization of Public Property in Poland



FROM USAGE TO OWNERSHIP

Transfer of Public Property to Local Governments in Central Europe

Decentralization of Public Property in Poland

Rafał Stanek

1. BACKGROUND

Decentralization in Poland began prior to the creation of fully operational local governments in the 1990s. Traditionally, since before World War II, administration in Poland was divided into about 2,500 municipalities (*gminas*), operating as local branches of the central government. *Gminas*, as basic administrative units, have operated up to the present day with practically unchanged borders.

The average *gmina* has a population of just over 15,000 residents and occupies an area of over 125 km.¹ Polish legislation distinguishes between rural (municipalities that consist of several villages), rural-urban (a town with surrounding villages) and urban *gminas* (cities). Naturally, the number of residents may deviate from the average; there are *gminas* with populations of 5,000, and there are large cities that constitute a single *gmina*. A unique status is reserved for the capital city of Warsaw.

In the 1980s, *gminas* received relative autonomy (*gmina* councils were elected) and more mandates from central authorities; therefore, it can be said that decentralization in Poland began in the 1980s.

In 1990, as a consequence of changes to the political system in 1989, local government at the *gmina* level was introduced. The administrative division stayed the same, while the local administrative system changed. Consequently, *gminas* were able to make the transition while continuing with their previous activities.

The following legal acts were of fundamental importance to the functioning of *gminas* in the 1990s:

- The Law on Local Government of March 8, 1990 (still binding under the name of the *Gmina* Government Law) defines the organizational structure of *gminas* and assigns tasks and competencies to individual *gmina* organs.
- The Budget Law (amended in 1999 by the Public Finances Law) regulates budgeting, revenues and expenditures.
- The Laws on Revenues of Local Government Units are short-term laws (binding for less than five years) specifying sources of local government revenues, particularly designed for transferring subsidies and grants.

The regulations for implementation of the Local Government Law and the Local Government Employees Law (*Legal Journal*, May 22, 1990) precisely described the process of transforming basic units of state administration into local governments.

In 1999, administrative reform was continued, introducing 16 provinces (regions) called *voivodships* and middle-level units (*powiats*) that consisted of several *gminas*. The names of these administrative units hearkened back to historical names used before WW II; in the case of *voivodships*, names were often several hundred years old.

One argument for such an organizational structure was the creation of stronger regions which could prepare and implement development strategies, taking into consideration the specific features of each region. The number of *voivodships* was raised (10 to 12 would have been most logical) in reaction to political pressure from larger cities that wanted to serve as headquarters of provincial authorities. Due to an array of tasks too broad for *gminas* and too narrow for *voivodships*, a middle administrative level—over 300 *powiats*—was introduced. Both new levels (*voivodships* and *powiats*) are self-governing, although *voivodships* also act as independent organs of central administration. In the course of the reform, the competencies of *gminas* were not changed. The newly introduced reform, however, had an impact on the extent of their tasks and finances, which will be discussed at the end of this report.

The structure of local government, its tasks and competencies, have had an important impact on the status of local government property.

Representatives who serve on *gmina*, *powiat* and *voivodship* councils are elected to four-year terms. *Gmina* councils consist of 15 to several dozen representatives, depending on the population of the administrative-territorial unit.

Executive management boards are elected by each *gmina* council and consist of 3 to 7 members. The mayor is the chairman of the management board. In 2002, the electoral system was amended, and now mayors are elected directly and have expanded competencies. The mayor and board manage local administrations employing anywhere from a dozen to several hundred officials.

Local government units have their own responsibilities but are also assigned tasks by the central administration or other local government units. Their responsibilities² include the following:

- land-use planning, local development and environmental protection;
- local roads, bridges and traffic control;
- water supply, sewage, public cleanliness, sanitation, waste disposal, waste treatment, electricity and heat;
- public transport;
- health care;
- social care centers;
- communal housing;
- education, including elementary schools, pre-schools and other educational institutions;²
- culture, including communal libraries and other cultural centers;
- sports and physical education;
- fairgrounds and market halls;
- public parks and woods;
- communal cemeteries;
- local public security and fire protection;
- communal public buildings and administration objects;
- social, medical and legal care for pregnant women.

Tasks³ exceeding the scope of individual *gminas* are assigned to *powiats*, such as:

- public education;
- health promotion and protection;
- social assistance;
- family support activities;
- support for disabled persons;
- culture and protection of cultural assets;
- physical fitness and tourism;
- surveying, cartography and control of the land registry;
- real estate management;
- spatial development and supervision of construction;
- water management;
- environmental and nature protection;
- agriculture, forestry and inland fisheries;
- public order and security;
- flood protection, fire protection and prevention environmental hazards;
- income and employment generation;
- consumer rights protection;
- maintenance of *powiat* public utility and administrative facilities;
- defense;
- cooperation with local government organizations.

Voivodships⁴ are assigned tasks of regional character, such as the following:

- public education, including university education;
- health promotion and protection;
- culture and protection of cultural objects;
- social assistance;
- family support policies;
- modernization and development of rural areas;
- spatial development;
- environmental protection;
- water management;
- public roads and transport;
- physical fitness and tourism;
- consumer rights protection;
- defense;
- public safety;
- employment and income generation.

The competencies of local governments are defined in detail in the Competency Law (e.g., determining which kinds of schools are the domain of which level of government).

2. TRANSFER OF OWNERSHIP TO LOCAL GOVERNMENTS

2.1 Transfer of Ownership in 1990

The *Gmina* Government Law of March 8, 1990 created local governments at the basic level which needed to be endowed with property. Local governments took over tasks that had been the responsibility of local branches of the central administration; therefore, a portion of state-owned assets became *gmina* property. State administration bodies that managed property on behalf of the State Treasury were obligated to transfer a portion of those assets to *gminas*. Those assets included state-owned property formally owned by the State Treasury (*documented* ownership). It referred both to real estate and mobile assets defined in the Law Regulating Implementation of the Local Government Law and the Local Government Employees Law, passed May 10, 1990. This law set the date for property transfer: May 27, 1990.

The law stated that the transfer applied to state property under management of local branches of the central administration and their subordinate units. All assets were subject to transfer: real estate, mobile assets and ownership rights to enterprises. The transfer was performed based on decision by the voivod (the representative of the central administration at the regional level—there were 49 regions in Po-

land at that time). A voivod was authorized to make such decisions if the State Treasury had ownership documents for those assets. As even under communism there was a private sector in Poland, state authorities took over a significant amount of property without arranging formal ownership status for assets (sometimes that was impossible). As a result, a significant portion of the property required legal documentation before it could be transferred to local governments. As a consequence, the process of property transfer continued throughout the decade. However, the bulk of property, particularly buildings and infrastructure for communal services, was transferred in a single transaction in 1990. In that year, *gmina* councils appointed commissions to take inventory of the property. Documentation was submitted to the voivod. By law, a voivod's decision served as the legal basis for recording ownership changes in real estate or enterprise registries. As some property belonged to regional entities whose purview exceeded the territory and/or competency of a single *gmina* (e.g., regional heat and energy enterprises), the property was divided between *gminas*, unless interested *gminas* decided to create a joint public utility enterprise.

Several problems occurred during the inventory process. First, inventory commissions consisted of new local government employees with limited skills and experience. The inventory protocol was a quite a simple document, containing very basic information about objects to be transferred; it did not involve a monetary valuation of the property.

An inventory commission had three months to perform an inventory, after which the inventory was presented to the public. An individual whose legal interests were affected by inventory findings was able to present his reservations to the inventory commission. The commission had to review such reservations immediately.

The inventory was submitted to the voivod, who approved it, thereby allowing ownership to be entered in the real estate or other registry.

If a voivod disagreed with some elements of the inventory protocol, arbitration authority was transferred to the National Enfranchisement Commission. Only these disputed objects were reviewed at the central level.

Disputes over ownership of state-owned electric companies led to a public discussion on the rights of local governments to participate in the privatization of such companies. Local governments sought 50% of electric company shares, but were unsuccessful.

The voivod had to postpone approval if the legal status of an object was unclear. Clarifying the legal statues of certain objects took over eight years.

In summary, the property transfer procedure defined by law was simple and clear for the majority of objects and was used in cases where legal status was clear. When doubt

arose as to whether the State Treasury was the owner, the long process of clarifying this ensued, and only then could the object be transferred. Thus, for a time, *gminas* managed roads with unregulated legal status.

2.2 Transfer of Ownership Due To the Transfer of New Mandates

The most important change in *gmina* competencies was the addition of elementary education to its list of tasks. This transfer was to be completed on January 1, 1994, but *gminas* could postpone the transfer to as late as January 1, 1996. Taking over the school network involved the transfer of property (school buildings) and financial responsibilities—salaries, maintenance and construction costs, etc.

Schools were transferred based on the amended Law on the Educational System of September 7, 1991. That law stated that schools assets transferred to *gminas* became *gmina* property on the day of the transfer. Thus *gminas* became owners of all school property, in particular land and school buildings.

In the 1990s, the school network was modernized. Due to a decreasing number of children (caused by the low birth rate), some schools had so few students that their continued operation was impractical. Therefore, *gminas* decided to concentrate students in selected larger schools and provide transport services for students from more distant areas. As a result, some empty school buildings could be used for other purposes.

Gminas, as managers of school buildings, decided to use them in a number of ways; here are some examples:

- The Dukla *gmina* sold an old, destroyed school building in Chyrowa to a private person who opened a bed-and-breakfast facility there. At present, renovation of the building is being completed. There are apartments on the first floor and multi-bed rooms for organized youth groups on the second floor. One of the renovated external walls serves as a climbing wall; a nearby small swimming pool and a ski lift are planned.
- Zabierzów *gmina* leased a school building to an NGO.

In 1999, the school system was reformed and a new level between elementary and high school was introduced: a three-year middle school (*gimnazjum*). *Gminas* manage this tier and needed buildings other than those used for elementary schools. In the first stage of reform, *gminas* did organize

middle schools together with elementary schools. In the past three years, however, they have had to find money for the construction of new schools. Thus, the school network has completely changed: old buildings are often unused and while new buildings are being erected.

Adding the management of elementary schools to the scope of *gmina* tasks has not been the only expansion of the *gmina*'s mandate in the past 12 years of local government reform. Pre-school management was passed to *gminas* in 1992, but the financial effect was much less significant.

In 1990, *gminas* also became owners of community housing. These consist of multifamily dwellings, usually rented to poorer citizens. Later on, the extent of community housing owned by *gminas* became even larger when *gminas* took over 'enterprise housing,'—dwellings built by enterprises for their employees, construction of which was subsidized by the state. These units were usually owned by large, state-owned enterprises from the heavy industry sector that experienced a serious crisis in the 1990s and consequently were financially unable to retain ownership of the apartments. Therefore, by law, *gminas* took over those premises together with their residents. A further history of 'enterprise apartments' is discussed in the following chapters.

2.3 Transfer of Ownership Due to the Creation of New Tiers of Local Government

As mentioned at the beginning of this report, further administrative reform was introduced in 1998. Starting in 1999, two new tiers were introduced to the administrative structure: *powiats* and self-governing voivodships. As in 1990, reform involved transfer of property to the new administrative units. The date of property transfer set by the law was January 1, 1999.

2.3.1 *Powiats*

Powiats were created based on the *Powiat Government Law* of June 5, 1998. An executive order by the Council of Ministers on August 7, 1998 defined *powiat* borders. Details of the reform were included in the *Law on Implementation Regulations for the Public Administration Reform Law* of October 13, 1998. This law contains provisions concerning organizational units transferred to *powiats* and voivodships. Of particular significance is the *Competency Law* (mentioned in the introduction to this report), as it defines precisely which tasks belong to the *powiat* mandate and, therefore, which state administration units are to be transferred to *powiats*.

The *Law on Implementation Regulations* appoints each voivodship a government delegate for reform (operating at the regional level). The most significant tasks of the government delegate are:

- coordinating the process of transferring institutions and organizational units or parts thereof to appropriate local government units;
- supervising registration of liabilities and inventory of premises, real estate, installations, equipment and documentation (including archives) of liquidated, transformed or transferred organizational units and their protocol of transfer.

The delegate supervised the transfer of new competencies from the central administration to local government units.

It should be emphasized that before this reform was implemented, there were so-called urban public services zones in Poland—pilot *powiats*. Those zones and their property were later transformed into *powiats*.

After the reform, *powiat* mandates included such institutions as: fire stations, regional police headquarters, regional veterinary inspectors, territorial sanitation and epidemic stations, employment offices, centers for surveying and cartography and other facilities. By law, *powiats* took over these units on January 1, 1999.

A problem arose when the operating area of a unit exceeded the jurisdiction of the new *powiat*. In such cases the following solutions were considered: division of the unit or an agreement defining which local government was to take over the unit. The government body responsible for supervising the unit carried out the division.

Similarly to other local government units, as of January 1, 1999, *powiats* took over elementary schools, special education schools, high schools and sports schools managed until December 31, 1998 by ministries or regional representatives of the central government (the 'old' 49 voivodships).

The transfer of all the units mentioned above served as the basis for the acquisition of property defined in Chapter 4 of the *Law on Implementation Regulations*. On January 1, 1999, state-owned property managed by institutions and state organizational units taken over by *powiats* and self-governing voivodships became the property of the new governments. Such property acquisition was formally approved by the respective voivod.

Unclear or unregulated legal status of property—land in particular—is a particular problem in Poland. This is a legacy of World War II and the subsequent regime's poor management. Thus, numerous state-owned facilities were built on land taken without appropriate legal procedures. The law relegated the costs of regulating the legal status of

property transferred to local governments to the State Treasury. This permitted the transfer of property with clear legal status to local governments.

Article 65 of the Law on Implementation Regulations provides that transfer of property is free and void of taxes and fees.

A *powiat* may also apply for transfer of other state property. Article 64 of the law limits such cases to property that can be used to execute the *powiat*'s tasks (of significance, then, is the list of *powiat* tasks). Such transfer can be completed based on an application by the *powiat* management to be approved by the voivod. The voivod is not bound to approve an application, particularly if the given property is used for different purposes. Therefore, in the beginning of their existence, some *powiats* had to incur significant costs of office construction as the property transferred to them was insufficient to their needs.

The transfer of property included liabilities bound into it, which had to be disclosed in the transfer decision. The transfer decision served as grounds for recording property in the real estate registry; that record was free of court charges.

By law, the following items were not subject to transfer:

- rivers and streams;
- riverbanks and river islands;
- areas between riverbeds and anti-flood dykes;
- anti-flood dykes including the areas on which they are located;
- retention reservoirs, dams, locks, weirs and other hydro-technical structures.

The law dealt also with State Treasury property under military management (the Military Property Agency) and ordered its transfer to local governments for purposes related to performance of public administration services.

The report mentioned the regulation of legal status. This was of particular importance in cases of roads; due to diffuse land ownership, many Polish roads were built on land not owned by the State Treasury. The law provides that such land, as of January 1, 1999, became the property of the State Treasury or a local government (depending on whose land the road traversed), subject to owner compensation.

Powiat and voivodship governments took over central government investments in progress if such activities were consistent with their tasks and competencies. As a result, *powiats* and voivodships acquired not only the property itself but the obligation to complete the investment as well. In that case, the law earmarked grants for local governments to continue transferred investments.

2.3.2 Voivodships

A similar law set the legal regulations for regional governments (voivodships). It should, however, be recalled that there is a smaller scope of tasks for voivodship governments and central administration branches operating at the same level. Legal regulations remained the same. Voivodship governments took over many central government investments in progress, thus there are many earmarked grants and investment outlays in their financial reports.

2.4 The Long Process Ownership Transfer

Let the following report from the small city of Luków on the state of municipal affairs serve as a description of failures in the area of property transfer:

The Constitution of the Republic of Poland, as well the *Gmina* Government Law called local governments into being. As a consequence, a portion of state assets became the property of *gminas*. Organs of state administration managing these assets on behalf of the State Treasury were obliged to transfer a portion of the assets to *gminas*. State property, for which the State Treasury had documentation of ownership, was subject to this transfer. This applied both to real estate and mobile assets as defined by the Law on Implementation Regulations of May 10, 1990. The inventory of State Treasury property subject to transfer (communalization) was conducted by the Inventory Commission formed by *Gmina* Council resolution.

The commission conducts an inventory of property based on resolution No. 104 of the Council of Ministers on the manner of conducting inventory of municipal property (July 9, 1990). The voivod renders the decision on the transfer of State Treasury property to *gminas* based on documents prepared by the Inventory Commission.

By the end of 1999, 429 hectares of State Treasury land had been communalized, which constituted 76.3 % of the area intended to be transferred based on the Law on Implementation Regulations. The voivod issued 1,092 decisions on communalization of 2,426 registered parcels.

The main reasons for delays in communalization of property were:

- lack of ownership documentation, necessitating the regulation of legal status of real estate in court;
- lack of current designations of real estate in appellate courts (especially property formerly owners by Jewish persons), requiring expert investigation into existing documents and real estate registries;

- lack of entry in the real estate registry for land intended for communalization;
- conflicts between the real estate registry and other documents;
- the need for surveying in order to establish the borders and surface area of real estate.

Table 5.1

Progress Toward Communalization in the City of Luków

Year	Communalized Area of Land [in hectares]
1991	81.2
1992	7.8
1993	183
1994	27.7
1995	65.3
1996	20.5
1997	19.6
1998	15.7
1999	8.2
Total	429

The voivod, based on article 18, paragraph 1 of the Law on Implementation Regulations, also issues decisions confirming purchase.

On January 1, 2000, the following schools were received:

- No. 1 with land of an area of 1.5 hectares;
- No. 2 with land of an area of 1.2 hectares;
- No. 3 with land of an area of 0.93 hectares;
- No. 5 with land of an area of 3.4 hectares.

The decision confirming purchase based on the Act on Primary Schools, issued at the end of 2000.

3. CHANGES IN THE LEGAL STATUS AND REGULATIONS ON MANAGEMENT OF MUNICIPAL ASSETS

In this chapter, procedures for changing the legal status of various groups of municipal assets will be presented, especially purchase and sale.

3.1 Real Estate (Land and Municipal Buildings)

Local governments can purchase and sell land and municipal buildings, as well as lease them or contribute them in-

kind to companies (as paid-in assets). It should be emphasized that, in accordance with Polish law, selling land occupied by a building also entails the transfer of ownership of that building. Therefore, it is not possible to sell or purchase only the building without the land on which it stands. Moreover, real estate may serve as collateral for payment of liabilities, including credits.

Purchase of land with and without buildings (in the latter case together with the buildings) requires the approval of the *gmina* council as the law provides that sale of assets exceeding the capacity of 'typical administration' require council approval. Because this report concerns asset changes that exceed the assumed typical administration in Poland, the *gmina* executive board cannot independently purchase and sell asset components, except for low-value mobile assets (administrative equipment, computers, etc.). The Local Government Act states that the *gmina* council establishes the rules for sale, purchase and encumbrance of real estate or its lease or rent for a period of less than three years. If the *gmina* council does not establish such rules, each purchase or sale of real estate requires the one-time approval of the council. Moreover, the council may allow the board to purchase and sell up to a pre-defined level without such approval.

Moreover, all *gmina* council resolutions, including budget resolutions (financial means for the purchase of real estate come from the budget) are checked by the Regional Accounting Chamber (*Regionalna Izba Obrachunkowa*—RIO), which constitutes the organ of control determining whether a resolution passed by a local government conforms with Polish law. RIO checks, in particular, whether public funds were spent on activities to meet the local government's own mandate or a delegated mandate. Therefore, the local government may not purchase just any asset, but only those that serve the performance of tasks at the given level of local government.

A further limitation on the ability to sell certain asset components was the required approval of the voivodship in the following cases:

- changes in purpose or sale of real estate serving general use or directly meeting public needs;
- changes in purpose or sale of objects of particular scientific, historic, cultural or natural value;
- relinquishing (sale without compensation) other components of municipal property.

When the new Local Government Act was passed in 1999, this limitation was removed and replaced by a statement that local governments decide the purpose and manner of using components of assets, provided that they adhere to requirements found in other legal regulations. Ten years of good local self-government experience convinced

the central government and parliament that introducing additional limitations would be pointless. Local governments expend enormous amounts of funds to expand their assets and they also rid themselves of components not essential to meeting their mandate.

A further step in purchasing real estate is the investigation of its legal status, in particular obtaining an entry in the real estate registry and checking whether the real estate is encumbered by some liability (e.g., a bank mortgage in the case of securing credit, usage rights for third parties, etc.). If the legal status is clear, purchase of the real estate may proceed. Purchase is conducted by a notary, who prepares a contract, collects all fees and taxes, as well as sends documentation to the court in order to complete all ownership changes in the real estate registry and to the *powiat* in order to make appropriate entries to the land registry. The *powiat* always informs the *gmina* about such changes, because the *gmina* collects property tax and must know the current ownership status of real estate. The procedure for *gmina* purchase of real estate ends at this stage. In cases in which the *gmina* council had previously established rules for purchase and sale of property, the procedure does not last long and depends mainly on the dates of obtaining real estate registry entries in the courts. The typical timeframe is two weeks to obtain a real estate registry entry in the case of investigating the legal status of real estate and at least two months for completing a new entry into the real estate registry. Sometimes, real estate has a few co-owners, of which a portion are difficult to reach (e.g., they are living or working abroad); in such cases the procedure lengthens. Obtaining real estate registry entries in some courts also lasts longer than the aforementioned two months.

In the case of sale of real estate, apart from approval by the *gmina* council, a tender must be conducted. The local public is informed of the tender, which is posted in the public procurement bulletin. Moreover, an assessment of the real estate is conducted by a licensed person; this constitutes the basis for establishing the opening bid price of the real estate. In the case of sale of more complex assets (land, buildings and associated infrastructure), the assessment may be expensive (encumbering the budget) and long-lasting. A bidder typically must pay a security deposit as proof of interest in purchase (the security deposit is returned to all those who lost the tender; the winner's is kept and goes toward the purchase price of the asset). If the tender winner does not sign a contract, he forfeits the security deposit and the local government retains it. Due to the need to organize a tender, the procedure for sale of the real estate is longer.

In the tender, the best offer is selected; in other words, the highest bid. Sometimes, the *gmina* may have stipulations as to the manner in which the sold real estate is used or

managed. In such cases, in the tender and subsequently in the contract, the appropriate restrictions are registered pursuant to later use of the real estate.⁵ Clearly, a tender may be organized in order to sell land to an investor who will build, e.g., a swimming pool or recreation center intended for local public use.

An interesting case is the *gmina* of Warsaw-Centrum. The *gmina* leased land for 30 years to an investor for construction of an office building; the investor will benefit from the investment from rental of office space. The *gmina*, however, in exchange for an exemption from leasing fees for several years, stipulated that the investor would designate a portion of the building space for a community library. Moreover, because the building is constructed on *gmina* land, it is the formal owner of the building, which after the contract period is over (30 years), will transfer to the *gmina*.

The opportunity to lease municipal property is often exercised by local governments that do not want to dispose of their property and want to maintain control of it, yet prefer that the property is used by another organization. Because this most often applies to property needed for the provision of public service, it will be discussed in later sections of this report.

3.2 Municipal Housing

Municipal housing is examined separately due to the more complicated history of this component of municipal property. As mentioned earlier, state housing in 1990 was transferred to *gminas*. In the 1990s, *gminas* also took over factory-owned housing. *Gminas* became owners of flats in which residents lived based on regulations left over from the communist period. 'Special' regulations gave tenants the right to reside in such housing, while the owner was limited in terms of raising rents or terminating rental by the occupant.⁶ Because maintaining municipal housing cost more than the *gmina* received in rent, *gminas* were eager to dispose of such assets. The special mode of rent, however, meant that there were no willing buyers of such housing together with tenants other than those tenants currently living in the housing. Because *gminas* were aware, however, that most of the tenants were not wealthy (those in better situations owned flats built by cooperatives or single-family homes), they offered large discounts.

For example, in Krakow, when a tenant purchased a municipal flat, the city conducted an assessment of the value of the flat and then applied a 90% discount; hence, the tenant could purchase the apartment for 10% of its value. Naturally, a contract for such a sale was coupled with a restriction on further sale; in order to prevent speculative purchases, the purchasing tenant could not sell the property for a period of 10 years.

The sale of municipal housing is not easy. The typical situation in a tenement-house is such that only a portion of the tenants purchase their flats. The *gmina* dispenses with the need to maintain only those flats that have been purchased, but remains the owner of the remaining flats. In such a case, many owners, including the *gmina*, have to form a 'housing community' in order to manage the tenement-house jointly. Decisions on repairs and renovation must be made by the entire community and financed by all owners in proportion to the surface area of the flat they own. Only when all apartments in the building are sold can the *gmina* completely be free of the problem of maintenance.

At the beginning of the 1990s it appeared that *gminas* would sell municipal housing to tenants. It turned out, however, that the poorest strata of society could not pay for its own flats and, despite the fact that government assistance programs exist, *gminas* often decide to build new buildings for rental of municipal flats.

Another interesting and increasingly popular solution to housing problems involving *gminas* are so-called Social Building Societies (TBS). They operate as a form of company, most often with *gmina* ownership, which, apart from acquiring shares, offer the companies municipal land on which to construct.

3.3 Schools

School buildings were described in detail in the section on new local self-government tasks. In theory, local governments have complete freedom in managing assets and are free to decide themselves what kind of school network will exist, but they must adhere to certain standards: e.g., there cannot be too many pupils per class and if the distance from the pupil's home to the school is too far, the local government must provide free transport.

Moreover, liquidation of schools often leads to social problems; residents do not want to agree to closings because they prefer to have small, yet closer schools. Sometimes

public pressure is so intense that the local government withdraws from the idea of liquidation or looks for other solutions.

3.4 Infrastructure

In 1990, *gminas*, and in 1999, *powiats* and voivodships became the owners of infrastructure. *Gminas* acquired the following infrastructure:

- water mains;
- sewers and wastewater treatment plants;
- heating networks and heating plants;
- roads (and local public transportation: buses and trams);
- public spaces.

Central government administrative units at the local level were the previous owners of the infrastructure. The basic problem of transferring ownership of infrastructure was their centralization in voivodship enterprises (at the time there were 49 voivodships, not to be confused with the 16 voivodship self-governments introduced in 1999), e.g., the Voivodship Thermal Energy Enterprise, which encompassed a dozen or even a few dozen *gminas* in its service area. In this case, the Central Government Delegate had to divide up the assets among each *gmina*, most often along territorial lines. *Gminas*, based on the divided assets, created their own enterprises (their legal form will be described in the next section).

From time to time local governments undertook joint action and, on the basis of divided assets, created joint enterprises.

For example, the Thermal Energy Enterprise (PEC) in Gliwice was founded from assets taken from the Voivodship Thermal Energy Enterprise in Katowice. A large heating plant and heating network were located in Gliwice to serve the entire city. Two other nearby *gminas* decided to contribute their assets to the Thermal Energy Enterprise in Gliwice. Therefore, the new enterprise served three *gminas*, each of which owned a share in the enterprise in proportion to the value of their paid-in assets. With time, it became clear that the interests of each *gmina* lay elsewhere, and at present PEC Gliwice serves only the City of Gliwice; the remaining *gminas* formed their own enterprises after parting with PEC Gliwice.

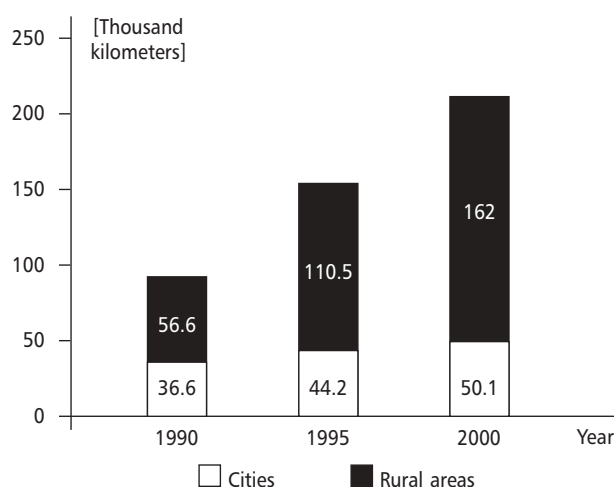
In subsequent years, local governments have significantly expanded the municipal infrastructure assets they acquired.

3.4.1 Water Mains

The total length of water networks that local governments acquired in 1990 amounted to 93.2 thousand kilometers. By 1995, this figure had risen to 154.7 thousand kilometers and by 2000 to 212.1 thousand kilometers.⁷ It more than doubled. In rural areas, this increase was even more significant: from 56.6 thousand kilometers to 162.0 thousand kilometers, almost a three-fold increase.

Figure 5.1

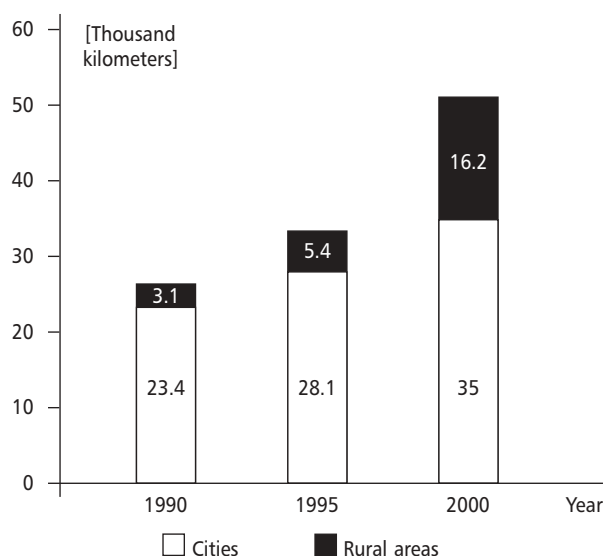
Increase in the Total Length of Water Networks



3.4.2 Sewers

Figure 5.2

Increase in the Total Length of Sewer Networks



As in the case of water mains, the length of sewer networks doubled over the past ten years of local government opera-

tions, from 26.5 in 1990 to 33.5 thousand kilometers in 1995 and to 52.1 thousand kilometers in 2000. Similarly, rural local governments made the most progress (or rather had the largest deficiencies) from 3.1 to 16.2 thousand kilometers.

3.4.3 Roads

An increase in the length of *gmina* roads took place, although roads were more often a priority for cities. Many problems in obtaining land with clear legal status slowed new roads development. Instead, local governments invested in modernizing existing roads and building new bridges with short accompanying roads.

3.4.4 Heating

Heating networks have expanded slightly since 1990; district heating enterprises, however, have faced problems of more efficient use of heat and decreased heat consumption. Consequently, modernization works (more efficient boilers and pre-insulated pipes) were municipal priorities.

3.4.5 Financing Development of Local Government Assets

Such a significant increase in assets, as presented in preceding sections, was, *inter alia*, the result of local government priorities. Polish local governments revenues consist of own revenues of which the most important are real estate taxes, a share in national taxes (a portion of income tax on private persons and companies), block grants (transfers from the state budget that local governments are free to use as they wish) and earmarked grants (transfers from the central budget that local governments must allocate to a pre-defined goal). Moreover, local governments often drew credit or, much less often, even issued bonds in order to finance the construction of infrastructure.

Debt is subject to some constraints. The two most important are:

- Debt servicing (loan repayment and interest) cannot exceed 15% of annual revenues.
- The total debt level cannot exceed 60% of annual revenues.

Another instrument a *gmina* can use to finance investment projects are municipal bonds. Due to the costs of preparatory work, which is usually conducted by a contracted

financial institution (typically a bank), this instrument is used only for a larger scale of financing. The financial institution is responsible for financial forecasts and analysis when issuing municipal bonds.

The tables and graphs below present local government revenues and expenditures⁸ from 1994 to 1998 (in current values).

Table 5.2
Revenues of Polish Local Government
[Million PLN]

	1994	1995	1996	1997	1998
Total	14,808	19,993	30,956	39,518	46,119
Cities	12,046	16,027	23,892	30,390	35,756
Villages	2,762	3,966	7,064	9,128	10,363

Table 5.3
Expenditures of Polish Local Government
[Million PLN]

	1994	1995	1996	1997	1998
Total	14,904	19,828	31,499	40,504	47,495
Cities	12,110	15,918	24,374	31,237	36,933
Villages	2,794	3,910	7,125	9,268	10,563

SOURCE: Central Office of Statistics (GUS)

Total Polish local government debt amounted to 12,266 million PLN (about 3 billion USD) on December 31, 2001.

Another means of increasing local government investment potential are environmental protection funds.⁹ These funds manage public money collected from environmental user charges and penalties (EkoFundusz manages funds from the Polish debt-for-nature swap mechanism) paid in by polluters (most often industrial plants) and dispense these funds as an earmarked grant for investments improving the quality of the environment. The selection of projects for financing is competitive; funds strive to subsidize investments that bring the largest environmental benefit at the lowest cost. Parallel to grants, especially now, funds increasingly award loans at lower rates than offered by commercial banks (preferential or soft-loans). When a *gmina* uses a soft-loan from an environmental fund, the terms and conditions are quite different: the physical and environmental effects resulting from the loan must be demonstrated. The scale of soft-loans is fairly large: about half of the local government's long term debt.

3.5 Joint Ownership through Associations of Local Governments

Local governments have the opportunity to form associations. Most such associations are lobbying groups, especially national associations. Associations are also formed in order jointly to develop infrastructure. Under the law, such associations have the same rights to ownership of assets as local governments, yet these associations have not been endowed with an initial asset portfolio. Moreover, membership dues are the main source of revenue for associations (from the local governments comprising the association) and local governments are reluctant to pay their revenues into some other organization. For this reason, most associations just co-ordinate actions and do not generate their own assets. One of the few associations that does develop its own assets and currently has a credit rating is the Upper Raba River Basin and Kraków Association.

In order to stop water degradation in the Raba river basin, the *gminas* located in the Upper Raba River Basin and Krakow created a legal entity and implement public projects under the association's name. The Association currently has 14 members—all *gminas* in the Malopolska Voivodship.

The first task of the association involved developing a document titled "Comprehensive Program for Maintaining Water Quality in the Raba River Basin Area—from the Source to the Dobczyce Dam."

This plan contains an inventory of the sources of contamination, proposed methods to neutralize the pollution and a fiscal calendar for the program's implementation.

The program is intended to provide a comprehensive solution to the problems associated with the collection and treatment of sanitary wastewater in the entire area of the Upper Raba Basin, from the river's source to the reservoir in Dobczyce.

The total value of the works and designs completed to date is 78 million PLN (about 20 million USD).

3.6 Shares in Enterprises

As mentioned, *gminas* in 1990 and *powiats* and voivodships in 1999 acquired organizational units at the local level together with their assets. Some of these units (operating over

an area larger than the territory of a single local government) were divided in order to transfer assets to concrete *gminas*. Municipal services, especially associated with water mains, sewers, supplying heat, removal of solid waste, municipal transport or municipal housing management¹⁰ were most often carried out by units subordinate to local governments.

Local governments use different legal entities to implement their tasks, invest in environmental protection and operate existing assets:¹¹

- *Budgetary units*: A budgetary unit is not a separate legal entity and is financed directly from the *gmina* budget.
- *Budgetary enterprise*: A budgetary enterprise, although also not a legal entity, is not financed directly from the *gmina* budget. Revenues collected from services cover all costs (there is no depreciation included in budgetary enterprise costs) and any surplus is transferred to the *gmina* budget. In the case of a deficit, a subsidy from the *gmina* budget is required. On the other hand, all investment costs are covered directly from the *gmina* budget.
- *Limited or joint-stock companies (with 100% or less of gmina shares)*: In this case, a company as a separate legal entity organizes and provides a municipal service, including investment and operation. Due to their scale, these investment companies have to incur debt and must seek funds on the commercial and soft loans market if possible.

The first two forms are legally autonomous units, yet in forming a company, a local government creates a separate entity. The local government exercises influence over the entity as owner of shares. Creating a company (in Poland, companies with one owner are permitted) most often involves the local government's paying assets into the company and taking over shares. Sometimes the local government has decided to pay in a small sum in cash that enables the enterprise to commence operations.

At the shareholders' meeting, at which local governments are most often the only shareholder, the owner can make decisions on development directions, select or recall an executive or supervisory board for the enterprise and make decisions on investment expenditures. Hence, if the local government is the sole shareholder of the enterprise, it exercises total control over it.

A typical problem of municipal companies in Poland is their poor financial condition. The *gmina* is responsible for setting fees for utilities. Very often, because of local political pressure, *gminas* set very low utility rates, which are not sufficient to cover operating costs. This reduces the ability of

the *gmina* to make investments financed from collected fees. The revenues from fees may not even be enough to cover maintenance. Financing such a deficit depends on the legal status of the utility. Budgetary units are financed directly from the *gmina* budget so other budget income covers costs. Budgetary enterprises and companies may receive subsidies from the *gmina* budget. Very often companies organize additional services (for example, maintenance of private utility equipment, organizing small specialized workshops) to cover losses.

Wod-kan, a limited municipal company in Krapkowice for water and sewage, organized additional services (water equipment repair and maintenance). Wod-kan generates losses, but due to depreciation and additional services, it has a cash surplus. It can continue long-term but cannot expand, replace or modernize the network in the future.

For this reason, investments are typically financed both partially from the local government budget and partially from the company's own sources. Local governments, in spending budget funds on investments, most often transfer them to the company while simultaneously increasing their shares in and control over the company. As receivers of assistance, *gminas* also prefer available cash from various types of funds (at the very least environmental protection funds mentioned earlier).

Local governments also decide to maintain assets as property without converting it into shares in companies and the infrastructure is leased to the municipal company or to some other enterprise.

Local governments may dispense with the shares they own in the same manner as other investors. Local governments must apply the Trade Company Code, which regulates joint stock and limited liability companies. They must also, in offering shares, apply the regulations found in the Act on Public Trade of Marketable Securities.

The scale of sales of municipal company shares in Poland, however, is small, because local governments prefer to maintain control over municipal services. Local government shares in other entities are not large; local governments do not have free funds to allocate towards such purposes.

The sale of shares in municipal companies is the beginning of their privatization. In larger cities, this process has already begun, although it is proceeding very slowly. For example, Krakow planned the privatization of its municipal companies but has shelved such plans.

An unusual example is the company AQUA from Bielsko-Biala. The City of Bielsko-Biala and several surrounding *gminas* own shares in this joint stock company that supplies water and treats wastewater. The city has increased its share of the company due to building additional infrastructure and transferring it into the company, thus raising its paid-in capital. AQUA was in good financial condition and, as a result, obtained a World Bank loan to develop its facilities. Total debt of the company (from different sources, including soft loans) at the end of 1999, reached 66.971 million PLN (around 16.5 million USD).

Shares of AQUA, as the first municipal company, were issued on the Warsaw Stock Exchange on the Central Table of Offers (which has slightly less stringent requirements than the normal exchange). Therefore, for the past few years, a portion of the shares have exchanged owners. As a consequence of share issue, the City of Bielsko-Biala found a British investor, to whom it sold 21% of shares. This revenue went into the city budget and could then be used for other purposes.

Another interesting phenomenon is the creation of municipal holding companies. On one hand, it is important that municipal companies have a strictly defined scope of activities and do not control all municipal services (although in smaller cities and towns, this is precisely the case; it simply does not pay to form several entities providing municipal services). Dividing up companies avoids the cross-subsidization of various types of activities and privatization of only certain companies. On the other hand, some municipal services often generate losses. Because municipal companies—like all companies—have to pay income tax on generated profit, companies that generate a profit pay taxes and those that face losses pay no tax. Forming holding companies allows entities to reap the benefits of operating as separate units, yet, at the same time, profit may be spread over the entire holding. As a result, a portion of income tax remains in the holding and may be allocated toward investments. The first municipal holding companies were created in Ostrów Wielkopolskie and in Krakow.

Public-private partnerships, as a method of building infrastructure, are slowly developing in Poland. This method involves using private capital for construction or modernization of local government infrastructure and then allowing the investor to glean benefits from fees. The benefit for the local government lies in obtaining infrastructure with-

out spending its own resources. The local government may also require expansion of municipal infrastructure (e.g., in the case of construction of large stores, local governments require that the modernization of roads in the vicinity and investors agree to this because such action also improves access to their facilities). Or, the benefit may be construction of some object of local government land, which is as a rule is well-located (e.g., when constructing a swimming pool on *gmina* property, in exchange for access to land, the investor signs a contract to open the facility to area schoolchildren from 8 to 15:30. These are the least favorable business hours for commercial sale of tickets and the investor will draw profits in the evenings and on weekends). Another example of public-private partnership is the organization of Energy Saving Companies (ESCO).

3.7 Other Components of Assets

Gminas also own current and financial assets (cash, receivables and inventories) as well as liabilities. There are no special regulations regarding these assets. *Gminas* and other tiers of local government have their own treasury offices, lead by a treasurer, who is responsible for local financial management. Local governments collect local taxes and co-operate with the State Treasury in collection of shared taxes (PIT and CIT).

3.8 General Transformation Tendencies Evident in Poland

In summary, the transformation tendencies evident in local government asset management are as follows:

- Municipal housing by and large has been sold to tenants. A trend is developing whereby *gminas* build new housing intended for rent.
- Land parcels are commonly sold and purchased in other places needed for construction of needed objects.
- Limitations in the sale of property have decreased significantly and local governments now have greater freedom of action to dispose of their assets as they see fit. Still, they typically only maintain assets needed for the execution of their mandate.
- Cases involving unregulated legal status are common, especially in the case of roads. Local governments must spend resources to put these issues in order (purchase of land, clarifying legal status, etc.).
- Local governments want control over municipal enterprises and as a result are reluctant to privatize them.
- The private sector is slowly entering into the municipal infrastructure construction market; the scale of this engagement is still small relative to need.

3.9 Regulations on Property Management by Local Government

In essence local governments have broad flexibility in managing their assets. Provisions of the *Gmina* Local Government Law in its current form do not contain any limitations, although limitations may appear in other regulations.

The law that regulates real estate management is the Real Estate Management Act passed on August 21, 1997. This law mainly applies to real estate owned by the state and local governments. The law establishes the manner of real estate assessment, applied in the sale of real estate owned by the local government. According to the law, the opening bid price for sale of real estate (the law also stipulates how the tender should be organized) cannot be lower than the price indicated by the independent property assessor.

Real estate owned by a local government may, according to the law, be sold, exchanged or relinquished, given over to perpetual use, rented or leased, lent, turned over for permanent administration, encumbered by legal limitations, contributed in lieu of cash (equity) to a company, transferred as equipment of the created municipal enterprise or assets of a created foundation.

Restrictions also apply when real estate is sold, turned over for perpetual use, lent, rented or leased if it is located in one of the following locations:

- 1) seaside coastal strips, requiring an agreement with the central government administration responsible for maritime issues;
- 2) mining areas, requiring, if no urban plan exists, an agreement with the central government administration responsible for granting mining licenses;
- 3) national parks, requiring agreement with the director of the national park;
- 4) border real estate turned over for permanent administration for purposes of national defense and safety, requiring agreement with the appropriate state government organ;
- 5) real estate entered into the monuments registry, subject to other limitations in turnover.

The law defines local government real estate and declares that the basis for real estate management is the spatial land use plan. Local government real estate assets can be used for purposes of local government development, for organized investment activities—especially completion of housing and technical infrastructure—and for execution of other public goals. According to the law, real estate management mainly involves the preparation of land surveying and legal documents and designs, subdivision and merging of real es-

tate, as well as equipping it, as far as possible, with needed technical infrastructure.

The law also addresses precedence in the purchase of real estate by its users. In particular this applies to flats owned by the *gmina*, enabling the *gmina* council to grant right-to-purchase priority to its tenants or lessees.

Of specific importance to *gminas* is a provision in article 22 of the Real Estate Management Law, which states that real estate owned by the State Treasury and intended in urban plans for housing construction and associated infrastructure can be donated to the *gmina* upon request, if a compelling *gmina* interest is demonstrated which cannot be achieved by the State Treasury. The donation contract specifies the goal toward which the donation is intended. In the event that the real estate is not used for this purpose, the donation may be rescinded. Thanks to this provision, local governments gained real estate with the proviso that they use it for housing construction.

Local governments, in particular those of larger cities that own significant assets, create real estate management departments (infrastructure for municipal services is typically turned over to the unit providing the services). This applies mainly to flats, buildings (including public works) and land. These departments organize tenders for lease, especially of public works buildings, attempt to sell flats to their tenants, as well as buy and sell land depending on need. The coordination of activities with other departments is also important (the next section contains more information on this).

In summary, local governments, especially smaller units, are still in the process of developing good real estate management skills. In the 1990s, many activities were chaotic, uncoordinated and of unclear purpose. By the end of the 1990s, most local governments had developed and approved long-range strategies and detailed strategies on asset management. Once in possession of these elements, local governments could begin to apply professional real estate management.

4. INFORMATION ON MUNICIPAL ASSETS

4.1 Real Estate Registry

Courts maintain real estate registries, which contain information on land parcel ownership. An entry into the real estate registry constitutes a basis for all subsequent actions involving the land: its sale, lease, etc. Real estate may also serve as collateral for securing loan payments. This security is noted in the real estate registry up until the moment the loan is

repaid. All local government real estate is contained in the real estate registry.

4.2 Enterprise Registry

The courts maintain the enterprise registry. All municipal companies are entered into the enterprise registry and information on them is publicly available through the National Court Registry (*Krajowy Rejestr Sadowy*). Financial reports of these companies are available from the registry and are subject to reproduction in special publications.

4.3 Information Published in the Local Government Budget

The local government budget is an annual financial plan published locally. It contains information on the local government's planned revenues and expenditures in a given year and may be desegregated to show expenditures on assets. The budget may also contain information on multi-year investment programs.

In the descriptive portion of the budget, a report on the status of municipal property is attached; it does not constitute a detailed financial report, but describes local government holdings. Some local governments prepare a more detailed report of assets even though this is not required.

Significantly, assets owned by municipal companies and their revenues are not published in the local government budget. For this reason, it is often difficult to compare local governments with one another. In 2000, a few cities decided to develop, as a pilot project, a consolidated budget containing information on property owned, including that by municipal enterprises (problems arose in cases where the local government was not the only company shareholder). Current law—the Public Finance Act—enables the minister of finance to introduce the obligation to prepare consolidated budgets; no minister has exercised this power, however, most likely due to the lack of an accepted methodology.

4.4 Statistical Information

Local governments, just as other entities, prepare statistical information for the Central Office of Statistics (GUS). However, data is often fragmentary, especially regarding municipal property. The ministry of finance collects information on budget execution. In 2000 (thanks to USAID assistance), a computer system was introduced to collect this information. Local governments enter data into their computer sys-

tems and then, via the Internet, send them to the Regional Accounting Chamber (RIO), which after synthesizing the information, sends the data on to the ministry of finance. As a result, the ministry of finance obtains current and complete information on local government finance (revenues and expenditures).

4.5 Property Assessment

Currently, property assessment is only conducted during sale. Local governments employ expert real estate assessors in the evaluation of real estate. This assessment serves as the basis for announcing a tender for sale of municipal property. In the case of housing sales, the expert conducts the assessment and then the local government applies discounts as mentioned earlier.

Real estate assessment is sometimes needed for calculation of real estate tax. In general, this tax is calculated based on the land area of the real estate. Ultimately (and this is already beginning), the tax will be calculated on the value of the real estate. Currently, local governments do not have databases on the value of real estate in their jurisdictions.

4.6 The Scope of Property Transferred to Local Governments

Some investigations claim that about 2 million objects were transferred to local governments. The whole process was decentralized and took place over several years; consequently no statistical data exists on the central level. Reports on the status of municipal property (attached to the municipal budget) are not standardized, and data is not aggregated.

The system of reporting to the ministry of finance is quite good and records budget revenues and expenditures but not changes in municipal assets.

The Central Office of Statistics conducts more general research about objects located in local government jurisdictions, albeit without consideration as to who the owner is.

5. IMPACT OF CHANGES IN MUNICIPAL ASSETS ON LOCAL GOVERNMENT BUDGETS

The sale of municipal property, including the sale of shares in enterprises, is treated as a local governments' own source of revenues. The scale of these revenues at the beginning of the 1990s was quite large—*gminas* sold housing and generated a fair amount of revenues. Currently, the level of reve-

nues from the sale of property has stabilized (see Table 5.4, below). On the other hand, expenditures on assets in 2000 and 2001 decreased compared to earlier years. In years prior to 2001, the scale of investment outlays made by local governments was a bit higher, and the increase in assets was consequently higher as well.

Table 5.4

Local Government Assets—Revenue and Expenditure

	2001 (Billion PLN) ¹²	% of Total Local Gov. Revenues
Local government revenues	79.6	100
Revenues from sales of assets	3.3	4.1
Expenditures on assets	16.1	20
Net increase in local government assets ¹³	12.8	—

As mentioned earlier, local governments also purchase real estate. If this is not associated with a transfer from the State Treasury (as in 1990 and 1999 or in conjunction with local governments being assigned new mandates), expenditure comes from the local government budget.

The scale of privatization of local government assets other than real estate—mainly municipal enterprises—is still insignificant. In 2001, local governments obtained 67.2 million PLN from privatization, a small fraction of their revenues. More common are cases in which the asset is leased for a period of several years.

On the other hand, local governments increasingly understand the role of local economic development and try to attract investors. For this purpose, industrial or service zones are created, in which the local government owns land that is equipped with infrastructure (water, sewer, electricity, telephones, convenient roads, etc.) and is intended for industry/services in local land use plans.

The City of Ostrołęka set up an industrial zone. The city had land at its disposal but also developed infrastructure and made the appropriate amendments to land use plans. Next, it developed an information folder on the terrain in the zone. The city has already attracted a number of investors but still has open land in the zone. For this reason, it was decided to send a brochure to German and Danish companies operating in the food processing sector (an appropriate branch for Ostrołęka), together with a cover letter inviting the addressee to invest.

The number of such industrial or service zones located on municipal land is increasing. Thanks to these actions, some cities have attracted firms that provide jobs for local residents. In effect, investors construct buildings on this real estate and pay taxes, especially real estate taxes, which are completely local.

6. EFFECT OF PRIVATIZATION OF NATIONAL ENTERPRISES ON LOCAL GOVERNMENTS

From 1990 to 2000, 6,691 state enterprises were privatized or liquidated; 794 enterprises were liquidated, 1,775 sold and 1,480 companies were transformed into companies wholly owned by the State Treasury.

The share of local governments in privatization is small, because the legal basis for this share has not been established. In 1990, such enterprises became *gmina* property (but were not privatized), provided that the enterprise was essential to the completion of *gmina* tasks. This is what happened to water and sewer, heating, city sanitation and mass transit enterprises.

The example of Krakow is instructive: In 1990 the city took over the municipal thermal energy enterprise. This enterprise delivered heat generated mainly at CHPs in Krakow and Skawina. Krakow included the CHP in the inventory protocol, but the voivod disagreed. The National Enfranchisement Commission asked the voivod to review process again, but still no agreement resulted. The CHP in Krakow remained the property of the state. The Krakow city council issued 7 resolutions that raised claims on the CHP Krakow. At the beginning of the 1990s, Krakow wanted to communalize the CHP; therefore, when the government announced its privatization plans, Krakow asked for 51% percent of the shares. In the next resolution, Krakow asked for 40%. In the second half of 1990, the process of CHP privatization began and the city expressed interest in receiving a smaller share packet from the privatized enterprise. When 55% of CHP shares were sold to a foreign investor and, pursuant to privatization law, 15% was reserved for employees, the City of Kraków asked for the remaining 30%. The last resolution was issued in 1999 and sought the inclusion of local governments in the privatization of the large monopolies.

The city argued that the CHP was providing heat for the city; despite its efforts, the city never received any shares.

After introducing further reforms in 1999 (introducing *powiats* and voivodships), local governments pointed out their right to receive shares in enterprises whose assets had been built by the local public. They justified their claims with local or regional public service enterprises. For instance, this applied to energy concerns (local heating or CHP plants, network distribution, gas companies, Polish Telecommunication, bus companies). Unfortunately, these actions were unsuccessful.

7. SUCCESSES AND FAILURES

It may be counted as a success that local governments received a large amount of assets and then expanded them significantly. Local governments did not receive assets that they did not need; therefore, there was no need to apply greater rigor on the sale of assets by local governments.

Property transfer to local governments was connected with local government tasks, and legislation gave provisions under which more property could be transferred in the event that new tasks were assigned to local governments.

As is evident from the report presented in the chapter 2.4—typical of many Polish *gminas*—the transfer of assets resulting from changes in 1990 went on throughout the decade. The main barriers are legal problems over land owned and controlled by the State Treasury.

Moreover, according to the law, local governments are responsible *inter alia* for supplying electrical energy (residents also assume local governments are responsible for supplying gas and telephones) but do not have any competence in supplying enterprises. Similarly, a significant portion of assets (e.g., arable land) is located in ineffective government agencies which could be relieved by transferring these responsibilities to local governments.

8. RECOMMENDATIONS

In some countries, the transfer of local government property took place without considering local government functions. This was caused by the need for the state to protect itself against the complete sale of property by local governments. Consequently, this brings about the need to classify property and apply a variety of limitations. For this reason, it is recommended to move away from the direct return of property based on its status from 1995. The scope of local government functions has changed over time, and new mandates can be expected in the future. The difficulties in conducting inventories of property expressed by conference participants demonstrate that Serbian local governments use a

portion of property for purposes other than those related to the functions they perform. Therefore, a better solution would be first to use the current list of functions performed by Serbian local governments as a starting point and based on this conduct an inventory and then transfer state property to local governments. Possibly, a new law should contain an obligation to transfer property in the event that the local government mandate is expanded in the future.

It is also possible to return property to the state as in 1995. In this case, it is necessary to consider a course of action in the event that property has changed owners or legal form (through transformation or privatization of enterprises) or if the legal situation is unregulated. Authorities will be anxious about the fate of property that is not essential to local governments for the performance of their functions. A mechanism insuring property is not wasted will be essential.

The uncontrolled sell-off of assets may be avoided by classifying property and limiting the freedom of control (especially sale) of certain types of property. Moreover, budget law may limit the use of revenues from sale of property to capital investments only. In this manner, it will not be possible to sell property in order to “consume” monetary sources (on current issues).

Regardless of the path chosen to return to the status of 1995 or transfer property linked to local government functions, it will be essential to take an inventory. This is a difficult task, demanding time and capability. Therefore, it is recommended that administrative procedures for such an inventory be developed, including:

- Develop the manner in which the body taking inventory is formed—a commission formed by the local government is advisable, but it might also be a mixed commission of local government representatives and local representatives of the national government or employees designated to fulfill this role; it is important to ensure that the proper level of administrative ability exists in the persons conducting the inventory.
- Establish the manner of the commission’s work, deadlines and level of detail of the protocol to be submitted.
- Define criteria for including a property on the inventory list.
- Define which central government body approves the list through, providing the legal basis for transfer of property.
- Define appellate organs, in the event that the local government does not agree with elements of the list (this may be a joint commission at the national government level or the administrative court).
- Define the competencies of each organ involved.

Moreover, the procedure or resolution should define the date upon which the property transfer goes into effect.

Because taking inventory is not an easy task, the commissions should be trained in the application of procedures. Therefore, the timeline for the entire process should be established so that once the procedures have been developed there is time and resources to conduct training at the local level.

Due to the large amount of local governments and components of transferred property, the entire process should be decentralized in order that the central government bodies deal only with appeals, in other words unclear issues.

It is important to ensure that approval of the list obligates registration bodies to register local government ownership.

Regardless of limitations on the sale of assets by local governments, it is important to ensure proper asset management. In particular, it is recommended to:

- Ensure proper local public control over the sale of property, e.g., through requirement of approval by the local council for sale of the property.
- Ensure proper and independent assessment of property intended for sale.
- Require competitive procedures (similar to public tender) in the sale of property.

In cases of particularly sensitive categories of property, the requirement to obtain the approval of the central government for sale may be introduced.

Moreover, effective property management should also include reporting. It is suggested that the reporting system be linked to the procedure for budget approval and reporting. A consolidated report on the state of communal property, in particular providing information on changes in property (purchases and sales) and, even better, changes in property values, should be submitted together with the budget. The report should be available to the public and collected by the central government administration for review and control purposes.

NOTES

- ¹ Based on the Local Government Law of March 8, 1990.
- ² Education was controlled by the central government until 1996, when it was transferred to *gmina* administrations. Educational reform in 1999 assigned management of middle schools (*gimnazjum*) to *gminas* and high schools (*lyceum*) to *powiats*.
- ³ Based on the *Powiat* Government Law of June 5, 1998.
- ⁴ Based on the *Powiat* Government Law of June 5, 1998.
- ⁵ Furthermore, the spatial land use plan of the *gmina*, passed by the *gmina* council, also contains a proviso on the manner of use of each zone.
- ⁶ This law applied and still partially applies to private owners of flats.
- ⁷ Based on data from the Central Office of Statistics (GUS).
- ⁸ Revenues, according to Polish classification, do not include long-term debt, and expenditures do not reflect payment of that debt. Therefore, the difference between revenues and expenditures must be covered by credits, loans or bonds, with consideration toward the need to pay debt incurred earlier.
- ⁹ A significant portion of infrastructure investments are for environmental protection, especially sewers with wastewater treatment plants, expansion of heating networks and modernization of heating plants.
- ¹⁰ Sometimes health service, although the legal construction of such units is a bit more complicated, because it must be in conformance with the act of health protection, which provides for special types of units and their registry.
- ¹¹ According to Article 9 of the Local Government Act of March 8, 1990.
- ¹² 1 USD = 4.0 PLN
- ¹³ Depreciations are excluded, because the scale of depreciation is hard to assess—local governments do not calculate depreciation.

COUNTRY REPORTS

Jaroslav Kling and Jaroslav Pilát

Decentralization of Public Property in Slovakia



FROM USAGE TO OWNERSHIP

Transfer of Public Property to Local Governments in Central Europe

Decentralization of Public Property in Slovakia

Jaroslav Kling and Jaroslav Pilát

1. Introduction

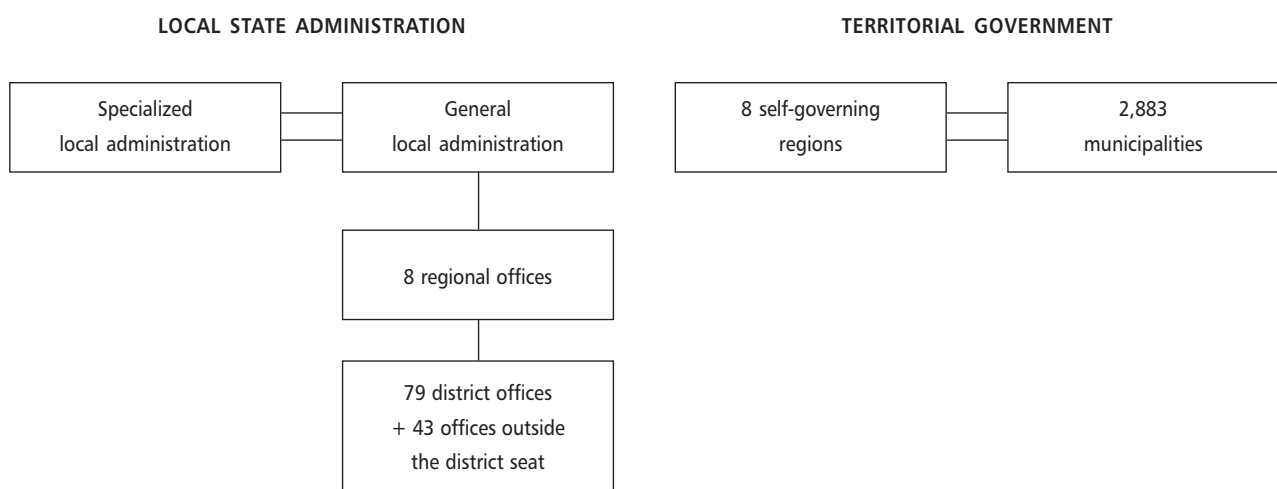
The social and economic changes of 1989 in Central and Eastern Europe included the reform of public administration in Slovakia. Already in 1990, a dual model of public administration was implemented. The Law on Municipalities of 1990 reestablished local government. The Municipal Property Law was approved in 1991. These two laws together with the Law on Local Elections form the core of the legal basis of local government in Slovakia. As for the central public administration, regions (*kraj*) were abolished and a new tier of local administration was created. Before the reforms, local administration consisted of 38 districts (*okres*) and 121 subdistricts (*obvody*) that were subordinated to districts. Along with these branches of central administration, there were specialized local administration bodies, subordinated to respective ministries, such as the network of tax offices, environmental protection offices, labor offices, etc. In 1996, a major change in local administration took place in Slovakia. Parliament approved the re-creation of regions (*kraj*), abolished subdistricts and networks of specialized public administration and extended the number of districts—the lowest tier of local administration.¹ The same year, Slo-

vakia was divided into 8 regions and 79 districts with an integrated model of local state administration, recognizing a limited number of specialized networks (tax offices, labor offices, etc.).

The next step in public administration reform was completed over a five-year period. In 2001, a regional level of local government was approved and eight self-governing regions (*samosprávny kraj*) were created. In 2001, the transfer of a number of competencies in various areas of public administration from bodies of local administration to territorial governments (local and regional governments) was approved as well. The transfer of tasks began on January 1, 2002—the date when self-governing regions started to operate in Slovakia.

In the last twelve years, the changes in public administration in Slovakia were primarily connected to central administration and only at the beginning of the new millennium did local governments (at the regional level) receive attention. Currently, the transfer of tasks to territorial governments continues; further reforms in local administration and local government are to come (abolishment of district offices, restructuring of local governments, etc.).

Figure 6.1
Current Organization of Public Administration in Slovakia



2. THE PROCESS OF PUBLIC PROPERTY TRANSFER

2.1 Time-frame of Property Devolution

Decentralization of public property in Slovakia (before the split-up of Czechoslovakia), more precisely the transfer of ownership of selected public property to territorial governments (municipalities and regions), was related to the democratic changes of 1989. Following these changes, the socialist Constitution of Czechoslovakia was amended in 1990. This amendment allowed the recreation of local government as an institution of public administration. Consequently, Slovakia approved the Law on Municipalities (369/1990) that defined local government, its operation and bodies, as well as relations between local government, citizens and other entities. In the fall of 1990, the first free local elections took place after 40 years, and local government was reestablished.

Although local governments were created in 1990, they had no property. The Law on Municipal Property (138/1991), approved in March 1991, became effective on April 1, 1991. Legally, this launched the process of property decentralization. This law defined which state properties were to be transferred to municipalities and set rules on the use of property by municipalities. At that time, the creation of a second tier of territorial government was considered. However, the creation of this tier and a respective transfer of property did not happen until 2001.

In October 1990, the federal Law on Transfer of State Ownership to Other Legal and Physical Entities (known as the Law on Small-scale Privatization²) was approved. This phase of privatization began in February 1991 and was completed by March 1994. The phase saw ownership changes in municipalities, as the process included the privatization of various trade, production or service facilities that were formerly managed by the national committees (*národný výbor*). These facilities were transferred to municipal management (not ownership) first, upon the Law on Transfer of Founders' Functions of National Committees to Municipalities, Central Government Bodies and Local State Administration Bodies (518/1990). Since the national committees were basically state bodies, these facilities were included in small-scale privatization.³

This law transferred founders' functions of state enterprises founded by the national committee and situated in the territory of the particular municipality. Certain state enterprises were exempted from this transfer—the food industry, water management, transportation, road construction, car repair, trade, recycling material collection and R&D for local economies. In these cases, founders' functions were

transferred to the respective government ministry. Besides these exemptions, the transfer contained special regulations in other areas as well.

In the case of budgetary and contributory organizations founded by national committees, management units⁴ were transferred to the municipalities in which they were located. There were other exemptions here—some organizations in the area of healthcare, transportation, culture, internal administration, environment, state archives, schools and school facilities, etc. Again, the transfer of the founders' functions to municipalities did not mean the transfer of ownership rights.

After the transfer of state property to municipalities upon the Municipal Property Law of 1991 (gaining the full ownership over property) and the end of small-scale privatization, there were no relevant changes in the area of property transfer to local governments.

The next important period of property decentralization began after the parliamentary elections of 1998. The newly-elected government, committed to continuing public administration reform, undertook profound decentralization measures. After expert preparatory work and often-difficult political negotiations, the legislative process to establish a second tier of local government and implement decentralization began in 2001. Decentralization was related to competencies, property, funds and political power; the weakening of central administration at the local level was to continue. After the decentralization of competencies and property, fiscal decentralization is planned to take place in 2004—still the subject of much controversy.

In this period, two laws were important for the decentralization of property. First, an amendment to the Municipal Property Law (447/2001) defines the transfer of further state property in relation to the transfer of competencies from state administration to municipalities, as well as some provisions on use and management of this property. Second, the Law on Property of Self-Governing Regions (446/2001) provides the transfer of state property to regional government ownership related to the transfer of competencies from state administration to regional government. Further provisions of this law contain the rules of management and use of this property. This phase of decentralization began January 1, 2002 and should be complete by 2004. Property transfer is tied to the transfer of competencies taking place in 2002–2004 in five phases.

Property decentralization has been in process for several years and is not over yet. The long time-period stems from the slow pace of the public administration reform that basically halted after 1991. This process was reactivated as late as 2001—after a ten-year pause.

2.2 Organizational and Institutional Setting of Property Transfer

The protocol on the transfer of ownership rights under the Municipal Property Law were elaborated by municipalities and sub-district offices (then the local branches of central administration). The next wave of state property transfer started after the amendment to this law in 2001. Protocols on property transfer must be signed by the mayors of municipalities and the statutory bodies of local administration (the head of the district office). As for the transfer of real estate, municipalities are obliged to apply for changes in the cadastre within 12 months of the transfer of ownership.

During small-scale privatization, privatization commissions were established in every district to organize and manage privatization in the particular district. The commissions were founded by the privatization ministry based on the Law on Ownership Transfer (474/1990). District offices were in charge of the commissions' operation. Members included representatives from local governments, representatives from the Association of Towns and Villages of Slovakia (ZMOS) and others as defined by law. Property to be privatized in small-scale privatization was published by each participating municipality on an announcement board.

The most important institution in the property transfer processes was the municipality. Article 65 of the Constitution states that "Municipalities and self-governing regions are legal entities which independently use and manage property and finances according to the law."

In property transfer to regions, property is transferred in relation to the regions' competencies (healthcare, social services, education, etc.). Like municipalities, regions must sign a protocol with the previous administrator of the transferred state property. These administrators are often the principals of the regional and district offices. Regions must sign protocols within two months of the transfer of ownership rights. However, there have been problems in practice. Regions often refuse to sign the protocols, since they are not elaborated precisely and the transfer of property is connected with unresolved issues. In the case of real estate, regions are obliged to apply for changes in the cadastre within 12 months of the transfer of ownership rights.

Relevant parties in property transfer were/are:

- 1) national committees, abolished in 1990;
- 2) sub-district offices, established in 1990 and abolished in 1996;
- 3) district and regional offices of state administration, established in 1996;
- 4) municipalities, reestablished in 1990;
- 5) self-governing regions, established in 2001.

2.3 Information on Public Property

In Slovakia, the privatization ministry takes care of state property. However, a complete and exact inventory of state property is not publicly available.

Real estate of any ownership is listed in the cadastre. Information in this registry is publicly available, on payment of a fee. Registration with the cadastre is necessary for claims of ownership rights for any real estate. Starting in 2002 the network of cadastral offices separated from the district offices. The body of central administration for this network is the Institute for Surveying, Cartography and Cadastre. Financially, the network is directly connected to the state budget. Despite efforts to reform the operation of cadastral offices, they still operate as budgetary organizations and decisions on funds flowing into the offices cannot be separated from politics. The offices are often understaffed, and the registration of ownership takes time. These problems leave room for corruption.

3. LEGAL CONTEXT OF LOCAL GOVERNMENT OWNERSHIP

3.1 Legal Provisions on Property Transfer

The Slovak National Council approved the Municipal Property Law (No. 138/1991) in the spring of 1991. The purpose of this law was to transfer state-owned property to municipalities and define the property status of municipalities and their use and management of their property.

The elementary provisions on municipal property are included in the Law on Municipalities. However, it is the Municipal Property Law that treats this issue in detail. According to the law, municipality property is to be used for the provision of the municipal tasks. Further, this law states that municipal property should be appreciated and kept intact—a provision difficult to enforce due to the right to free use of property by municipalities. Municipalities in Slovakia are allowed to enter into business activity, by nature involving a degree of risk. There is no guarantee that property invested into business will be returned intact. The Law on Municipalities forbids donating municipal real estate not defined in a special law. Municipal property that is used for public purposes (e.g., local roads and public spaces) is widely accessible and can be used unless limited by the municipality.

The Municipal Property Law defines transferred property. However, it does not name the exact properties to be

transferred. Municipalities were given the following state property:

- Every property managed by national committees and located in the territory of the municipality, except property belonging to bodies of local administration.
- Small production, service and trade facilities became municipal property if:
 - 1) They were not listed to be privatized during small-scale privatization.
 - 2) They were listed, but the privatization was unsuccessful.
- Property of state companies, budgetary and contributory organizations and the founder's function was transferred to central government bodies or the respective body of local state administration (requiring agreement between the respective administrative branch and the municipality).
- Towns received historic town halls owned by the state.
- Real estate under the managerial control of selected enterprises (for example, the Bratislava Construction Company) or former district committees when the Law on Municipalities became effective. Real estate was transferred to the municipality of which they were located.
- Real estate formerly under the administration of sports organizations (*športovo-klubová jednotá*) abolished by the Law on the State Property Administration. Municipalities were obliged to continue to dedicate such real estate to its established purpose (public sports activity).

Municipalities were given buildings, land plots, forests, roads, parks, unused and public spaces, selected enterprises, sports facilities, facilities for cultural events, daycares, etc. In the first round—at the beginning of the 1990s—municipalities were not given property in the area of healthcare, welfare or education.

Under the “second wave” of property decentralization, initiated when the Municipal Property Law was amended in 2001, further state property has been transferred to municipalities. This law transfers ownership to municipalities of properties to which founders' functions were transferred by the Competency Law (416/2001).

The Municipal Property Law allows for the transfer of other properties based on agreements between municipalities and respective local administration bodies. Every property mentioned is transferred to the municipality in which it is located.

The law does not provide an exact list of property to be transferred, but it does define the following properties that *cannot* be transferred to municipal ownership:

- property of which state ownership is forbidden by the Constitution;
- private land;

- real estate under state ownership used by a non-state organization, except for property listed above (schools and social services);
- property of schools, school facilities and other facilities under managerial control of national committees, the founders' functions of which were not transferred to municipalities (not including real estate belonging to schools which is not used for educational purposes)⁵;
- facilities for education, healthcare and welfare constructed within the program of complex housing construction, except facilities constructed through Action “Z” (a voluntary construction project during state socialism);
- technical infrastructure—water supply, sewage, gas supply, adjusting station for gas pipeline, electricity distribution, transformers, telecommunications, TV and electricity distribution constructed within the complex housing construction;
- real estate used for foreign diplomatic, cultural and information facilities;
- facilities forming the civil emergency system.

Municipalities gained related property rights administered formerly by national committees, state enterprises and budgetary organizations. These rights were transferred to municipal enterprises and budgetary organizations to which founders' functions were transferred to municipalities (under law 518/1990). The respective organizations gain the right of administration over these properties, while ownership remains in the hands of the municipality.

Together with property, liabilities were transferred as well. Transferred liabilities, however, amount only to the value of transferred property. Municipalities did not take over:

- liability for payments for supplies and services that are overdue and not settled by the date of the transfer;
- liabilities for taxes, welfare and health insurance payments, etc. that were overdue and unpaid on the date of transfer.⁶

Slovak legislation enables municipalities the right to joint-ownership, regulated by a special law (the Civil Code provisions on co-ownership).

3.2 Self-governing Regions and Property Decentralization

After 1998, the works on public administration reform had started. They resulted in the approval of several laws in 2001. The creation of regions completed the process of establishing elected bodies in Slovakia (with the Law on Regional Self-Government, 302/2001). During these reforms, com-

petencies and respective property were transferred to regional governments. This transfer is detailed in the Law on Regional Self-Government Property (446/2001)—known as the Regional Property Law.

As regards property, the Law on Regional Self-Government is similar to the Law on Municipalities. Likewise, the Regional Property Law has provisions very close to the Municipal Property Law. Only the most important features of this law will be explained here.

Regions received property that had been administered by:

- legal entities, of which founders' functions were transferred to regions in accordance with the Competency Law (416/2001);
- founders of vocational education and training centers without legal independence;
- founders of welfare services facilities without legal independence, of which the founders' functions were transferred to regions by the Competency Law.

Regions also take over liabilities related to transferred property. The law defines what liabilities do not transfer:

- liability payments for supplies and services that were overdue and unpaid on the date of transfer;
- liability for tax, welfare and health insurance payments.

Regions can use property just as can municipalities. They cannot, however, use the property to establish a new legal entity.

The law defines rules for property management and use. Regions must maintain the use of property that was intended for education, welfare support, health care or cultural purposes at the time of transfer. This obligation can be canceled only through the exclusion of the facility from the network of particular facilities (by law regulating the respective field).

Regions also received founders' competencies over museums, galleries and other historical and cultural facilities. The use of these facilities is regulated by the Law on Preservation of Cultural and Historical Heritage (known as the Heritage Law). Regions cannot alienate such property; repairs and reconstructions must be undertaken under expert supervision, etc.

Further matters relating to property use and management by regions are regulated by provisions relating to those regulating municipal property use and management.

3.3 Regulations on Property Management by Local Governments

A municipality is allowed to assign its budgetary or contributory (what is called an "indirect budget beneficiary" in Ser-

bia) organization to administer its property. Municipalities are further allowed to use property to invest in a commercial company or to form the basis of a new legal entity. This provision excludes property used for education and related activities, welfare support, healthcare and culture. The municipality is obliged to continue a single-purpose assignment of such property. This obligation is canceled upon:

- exclusion of school facilities from the school network according to the Schooling Law (29/1984);⁷
- exclusion of a social service facility from its network by the authorized body (e.g., the relevant ministry);
- closing of the facility under a special law;
- decision of the municipal council in cases of surplus or unusable tangible assets.

Property transferred in selected areas (education, welfare support, healthcare, culture) cannot be used as collateral and cannot be declared in bankruptcy cases.

Municipalities and respective organizations are obliged to manage and use municipal and state property to develop the municipality, serve its citizens and protect the environment. These institutions are obliged to develop, protect and appreciate the municipal property. This obligation includes:

- maintenance and usage of property;
- protection of property against damage, destruction, loss or abuse;
- use of all available legal means to protect property, including use of ownership rights or interest;
- entrance of property in relevant registries.

3.4 Limitations on Local Property Management

The use of museum and library collections are regulated the Heritage Law.

According to this law, a municipality must protect, renovate and make use of the cultural artifacts in its territory. The municipality ensures that owners of cultural artifacts act in accordance with this law, coordinating construction of technical infrastructure to protect historical sites and cooperating in the construction of historical parks, public lighting and advertisement to raise historical and cultural awareness. The municipality supports civic initiatives to protect artifacts and sites and maintains a monument registry. The municipality is allowed to collect contributions and funds for the repair and renovation of monuments in its territory.

The municipality is responsible for the management of the cultural heritage registry, which includes movable remains as well as real estate, natural and man-made items, historical events, street names, geographical and cadastral names, etc.—anything connected to the history of the mu-

municipality and its citizens. The municipality submits this registry to the regional heritage office (*Pamiatkový úrad*); in the case of real estate, the registry is submitted to the construction licensing office as well (*Stavebný úrad*). Entries in the registry are subject to further detailed limitations for use by municipalities.

Municipalities received land and forests that they owned prior to nationalization in 1949. Together with land and forests, municipalities gained the agricultural, water treatment and forestry facilities they owned prior to 1949, if the facilities belonged to the state on the date of transfer. A municipality could deny the transfer of such objects in special cases—mainly related to national parks and other protected areas.

3.5 Distribution of Competencies within Local Government

The Municipal Property Law defines certain rules of property management. The key players are the municipal council and the mayor.

The municipal council must also approve rules for municipal property management, including:

- rights and obligations of organizations established or founded by the municipality in order to manage municipal property;
- prerequisites for alienation of municipal property from organizations founded or established by municipality;
- use of securities;
- a list of activities that must be authorized by municipal bodies.

According to the Municipal Property Law, the following activities must be approved by the municipal council:

- transfer of real estate ownership;
- transfer of movable assets above a value set by the municipal council;
- operations concerning ownership rights of a defined value;
- auctions according to special regulations;
- investment of real estates to the property of new or existing commercial companies;
- investment of other property of a value defined by the municipal council in new or existing commercial companies.

The mayor is the statutory body of local government. Since the municipality is a legal entity, the statutory body is authorized to act on its behalf. The statutory body must authorize any transfer of property. There are operations with

municipal property that do not require approval by the municipal council. These operations are defined by law or by the approved municipal property management rules. In the case of such operations, the approval/signature of the mayor is sufficient.

The Law on Municipalities obliges the municipality to have an auditor-in-chief. The auditor-in-chief is appointed by the municipal council for a six-year term. The council is the only body that can recall the auditor. The auditor is an employee of the municipality and reports to the municipal council. The auditor-in-chief has the following duties:

- Control municipal budget revenues and expenses, use of municipal property and operations by budgetary and contributory organizations.
- Provide expert opinions on the municipal budget financial statement prior to their approval by the municipal council.
- Submit results of control activity directly to the municipal council.
- Report to the municipal council at least once a year on control activities.
- Cooperate with respective administration bodies on matters of use and management of state budget transfers to the municipality.

According to the Law on Municipalities, the municipal council must form expert commissions on various topics, including property management. More often, however, the municipal council forms a commission to supervise the municipal economy as a whole. Commissions are advisory bodies; their decisions do not create obligations for the municipality.

In cases of territorial changes, municipalities must settle their own ownership relations. The courts arbitrate conflicts that arise from transfer of ownership rights, property rights and state liabilities to municipalities. The courts are authorized to act on any property conflict connected to the transfer ownership rights from the state to municipalities.

4. ECONOMIC CONTEXT OF PUBLIC PROPERTY DECENTRALIZATION

4.1 Scale of Municipal Property

There is no summary of the scale of transferred and other municipal property in Slovakia. Even the Association of Towns and Villages of Slovakia (ZMOS), the organization representing 90% of municipalities in Slovakia, does not provide such information. The ministry of finance keeps

records on municipal budgets and financial statements, but their information proved inaccessible and incomplete. Therefore, the scale of municipal property is provided here in very rough estimates and quite inconsistently.

In 1992, municipalities received 330,000 previously state-owned apartments. In subsequent years they received an additional 20,000 apartments. Today, municipalities own almost 40,000 apartments (about 2.4% of the total number of apartments in Slovakia). In the beginning of the 1990s, municipalities took over unfinished housing, technical and social infrastructure objects as well, valued at around Sk 12 billion.

Municipalities own about 180,000 hectares of agricultural and non-agricultural land. Along with this land, municipalities own almost 192,000 hectares of forested land. Forests were transferred to municipalities as part of the process of restitution. Municipalities also own facilities for agricultural and forestry production that were owned by municipalities before 1949.

The privatization of healthcare facilities will be completed in 2003 (Table 6.1).

In the last four years, municipalities received 119 healthcare facilities, mostly local clinics and polyclinics, valued at Sk 474.329 million.

More about the scale of municipal property can be found in municipal financial statements. However, these documents do not directly describe property value. Balance sheets provide the value of resources covering fixed and floating assets

of budgetary and contributory organizations—about Sk 196.3 billion in 2001. Property funds accounted for Sk 192.7 billion of these funds. In comparison, at the beginning of 2000, own resources amounted to Sk 173.6 billion.

More precise and consistent records of property transferred to municipalities will be available after transfer protocols are signed. These protocols contain a detailed list of property being transferred together with the competencies under which they are used. Municipalities and regions are receiving substantial property—founders' rights in many areas of welfare services, primary and secondary education, culture and healthcare are gradually being transferred to self-governments.

4.2 Property-related Revenues in Municipal Budgets

Even though the exact scale of municipal property is difficult to estimate, available data gives a picture of property-related revenues to municipal budgets. These revenues consist of:

- sale of buildings, apartments and land plots;
- enterprise and ownership revenues;
- municipal apartment rentals;
- transfers from contributory organizations;
- sale of shares;
- interest on deposits and loans.

Table 6.1
Transfer of Healthcare Facilities to Municipalities

1999		2000		2001		2002	
Units	Value [Thousand Sk]	Units	Value [Thousand Sk]	Units	Value [Thousand Sk]	Units	Value [Thousand Sk]
7	10,949	80	145,347	16	43,325	16	274,708

SOURCE: Privatization ministry.

Table 6.2
Municipal Property Related Revenues
[Millions of Sk]

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Property revenues total	51.2	106.1	1,903.7	1,905.2	2,163	2,265.9	2,970.9	3,366.3	2,644.5	4,895.5	4,781.6
Sales of real estates								2,758.9	2,122.8	2,535.8	2,525.1

SOURCE: Municipal financial statements 1991–2001.

In the past, the sale of municipal property served for balancing missing funds for operational expenditures of local government. Starting in 2002, municipalities are not allowed to use revenues from municipal property sale for these purposes. Such funds can be used only for new investments (construction of facilities, etc.) or municipal debt settlement.

The financial authority of local governments is insufficient, and municipalities often lack funds for covering their assigned functions. Since municipal tax revenues are more or less still defined by the state budget, municipalities must seek non-tax revenues. Total revenues of municipal budgets were Sk 32.7 billion in 2001. Transfers from the state budget (shared tax revenues, subsidies for small municipalities and other subsidies and transfers) have reached Sk 11.75 billion. Revenues related to municipal property ownership account for about Sk 4.8 billion (14.7% of total revenues). Further significant sources of municipal revenues were real estate taxes (Sk 3.7 billion) and credits (Sk 2.7 billion).

The breakdown of property-related revenues points to the reasonable use of municipal property. In 2000 and 2001, municipalities received significant revenues from property rentals—Sk 1,095 million and Sk 1,120 million respectively (for buildings, apartments, land plots, etc.). This is a more favorable use of property, as revenues are repeatable. The fact that property sales have not risen in the last two years indicates that municipalities are learning more responsible ways to use property.

Table 6.3

Breakdown of Property-related Revenues in 2001

Revenues Source	[Million Sk]	% of Total Revenues
Sale of real estate	2,525.1	7.72
Enterprise and property ownership	449	1.37
Property rentals	1,120	3.43
Municipal apartment rentals	367.4	1.12
Transfers from contributory organizations	171.7	0.53
Sale of shares	148.4	0.45
Interest on deposits and provided loans	192.2	0.59
Total revenues/ % of total revenues	32,700	15.21

SOURCE: Municipal financial statement.

In Bratislava, revenues totaled Sk 2.85 billion in 2001. In the same year, the city sold property worth Sk 406.7 mil-

lion. Revenues from property rentals reached Sk 187.2 million; enterprise and property ownership, Sk 7.5 million; transfers from contributory organizations, Sk 3.5 million; sale of shares, Sk 86.9 million; and interests on deposits and provided loans, Sk 88 million. Overall, property-related revenues in the City of Bratislava budget (not including district budgets) totaled Sk 779.8 million (27.4% of total revenues).

4.3 Sale of Municipal Property

The scale and value of municipal property that is suitable for sale is directly proportional to the size of the municipality. There are several kinds of municipal property with various meanings in terms of privatization. Sale of property brings revenue to municipalities; however, local governments must maintain property that is difficult to sell.

Privatization of municipal apartments was probably the most problematic process in municipal property privatization. The original motivation for the transfer of apartments to municipalities was that these apartments would be sold in order to generate revenue for further housing construction. However, calculations proved this idea wrong, as revenues were insufficient even for maintenance of existing municipal housing. Moreover, municipalities had to cope with the issue of unfinished KBV units (complex housing construction).

The sale of municipal apartments began in 1992. However, a number of obstacles had to be addressed first. Several amendments to several laws were approved. Another problem was insufficient capacity of cadastral offices when citizens overburdened some offices with applications to register ownership of former municipal apartments. Municipalities retained about 10,000 apartments for permanent exclusion from privatization. Due to these problems, sale of municipal apartments has not been completed. After transforming former municipal enterprises, the maintenance and administration of their apartments was put in the hands of municipal administration companies (private/municipal, etc.). Operation of such companies was often very non-transparent and there was much fraud in municipal pro-property administration.

Agricultural and non-agricultural lands form another category of municipal property suitable for sale. Sale of non-agricultural land takes place individually from municipality to municipality. Primarily, attractive construction sites have become a vital source of finance. These plots were sold mainly through real estate agencies and public tenders. However, even this process has been plagued by scandal and corruption. Recently, municipalities have realized the value of hous-

ing construction for local economic development. They offer land plots from utilities for symbolic prices as a way to address housing and employment issues.

Municipalities established special municipal companies to administer forests and forestland. Profits from such companies go to municipal budgets. Forests are often used as collateral, and in many cases municipalities have used the sale of municipal forests to cover municipal debt.

For example, in 2001, the city of Košice was on the verge of defaulting on loans in excess of Sk 2 billion. In order to meet the conditions of the settlement, Košice needed to lower the debt to Sk 1.2 billion. The city wanted to fulfill this condition by selling city forests. The original idea was to sell about 20,000 hectares of forests for Sk 3.5 billion, later decreased to Sk 2.5 billion. There was no demand for such a purchase. The city turned to the state to buy the forests for about Sk 1 billion, but the state came up with a different way to help. The city received a 15-year state loan guaranteed by city property and the bank took over the remaining debt settlement. This solution, however, turned out to be insufficient for solving the financial situation of the city, and Košice continues to search for a buyer for its forests.

Buildings are the largest source of privatization revenues for municipalities. The disadvantage of this is that municipalities often sell buildings that could later be used more efficiently by the municipalities themselves. However, financial difficulties force municipalities to sell them. Corruption and fraud are not unknown in this area either. So far, however, no local government representative has been sentenced for municipal property fraud or corruption because of the sale of municipal property.⁸

4. 4 Significance of Privatization (and Compensation)

Most revenues come from the privatization of properties that were not transferred by the Municipal Property Law. Second in importance is the privatization of municipal property. Third, funds with which municipalities are reimbursed for the construction of utilities after the privatization of state utilities companies (gas and electricity distributions) and the transfer of state water and sewage companies to municipalities.

4.4.1 State Property Privatization Revenues

Municipalities participated in the privatization of state property that was not included in the Municipal Property Law or

other aforementioned laws. Such property was to be privatized in two phases—small-scale and large-scale privatization.

Small-scale privatization was governed by the Law on Small-scale Privatization (427/1990—in Czechoslovakia). This law transferred ownership of service and retail organizations, and organizations not related to agricultural production. Basically, it was a way to quickly privatize retail and tourism facilities and service businesses through the public auctions (Nížňanský and Reptová 1999). Property that was not successfully sold in public tenders and auctions was transferred to municipal ownership. Similarly, property of special importance to local governments that was not included in property laws was transferred to municipalities. Along with the transfer of about 490 facilities during small-scale privatization, municipalities received revenues from the privatization of enterprises, to which the municipality had received founders' rights. In 1993, 1994 and 1999, municipalities received 25% of such revenues, totaling Sk 1.05 billion.

Large-scale privatization involved the privatization of large economic entities such as manufacturing enterprises, banks, insurance companies, large trade companies, etc. It was regulated by the Law on Large-scale Privatization (92/1991). Large-scale privatization occurred in two phases using several methods (vouchers, direct sale, tender, auction, etc.). During the first phase, municipalities took over property worth Sk 886 million—mostly comprising privatized companies' housing units, daycares, kindergartens, recreation facilities and land plots. Some municipalities became shareholders in various companies (Bratislava, Košice and Poprad gained the shares in CSA airlines; Topolčany in Topvar brewery; Humenné in the Chemes chemical production company; spa municipalities became shareholders in the local spas, etc.).⁹

In large-scale privatization, privatization of public bus transportation companies (SAD) was especially relevant to local governments. In 2002, a 49% stake of 17 regional SAD companies was sold to private companies. The remaining 51% stake remained under National Property Fund ownership. In the second phase of the transformation of SADs, the National Property Fund will transfer 34% of its shares to regional governments. This transfer will be connected to the transfer of competencies in the area of road management and transportation.

4.4.2 Privatization and Infrastructure Development

Privatization of state utility companies is closely connected to the issue of municipal property. There are two dimen-

sions to this problem—state water and sewage companies will be privatized, and municipalities will be reimbursed for the construction of utilities with revenue from the privatization of gas and electricity companies.

By law, municipalities are responsible for water supply and waste disposal within their territory. However, state companies (*Vodárne a kanalizácie*) still deliver water and provide wastewater collection and treatment few (a few small municipal companies began operating in these areas over the last three years). In the past, construction of the water supply, sewage and wastewater treatment facilities were primarily financed by municipalities. These constructions were transferred to the state later. Municipalities pushed the government to transfer these companies to municipalities, and this process started in the mid-1990s. In 2001, a government resolution set the final procedures for transformation. The government approved the establishment of six municipal water supply companies (despite a proposal from municipal leaders to form eight). In 2002, privatization proposals for creating these six companies were approved and transformation of the state companies into stock companies was to be completed by the end of 2002. The final number of companies after transformation will probably be seven. Property and functions of original state companies will be gradually transferred to these new municipal companies. The value of property to be transferred to municipalities totals Sk 37.9 billion. After the transformation is complete, municipalities will most likely look for private investors to invest in these companies. Property ownership should, however, remain in the hands of municipalities, with private companies only serving as managers.

Similarly, municipalities requested the transfer of shares in state energy and gas companies. The rationale for such a request is that municipalities paid for and constructed gas and electricity distribution lines, regulation stations for gas supply and electric transformers under Action Z. In this case, municipalities are asking only for compensation for payments made by their citizens. It is difficult, however, for municipalities to prove which facilities should be included. The expense of such constructions will be difficult to estimate as well. Therefore, municipalities must find a way to demonstrate the amount of their contribution. Even after 1989, the law obliged municipalities to transfer gas distribution lines, electricity distribution lines and other facilities constructed from the municipal sources to respective state companies free of charge. The irrationality of such an obligation is further stressed by the fact that citizens must pay for the use of infrastructure, the construction of which they financed themselves.

Municipalities have lobbied for reimbursement of their investments into gas distribution lines since the late 1990s,

when the first information on potential privatization of SPP (*Slovenský plynárenský priemysel*—the gas company) appeared. Municipal leaders proposed that compensation should come from revenues from the SPP's privatization. The company provided partial compensation before 1999, when almost Sk 1 billion was transferred to municipalities (another Sk 0.5 billion was transferred in 1999 and 2000). In 2002, a 49% stake in SPP was sold to a consortium of foreign gas companies, and ZMOS succeeded in lobbying for further compensation (Sk 4.073 billion was distributed between 1,500 municipalities). This amount was transferred to the municipal bank (PKB—a specialized municipal bank) and municipalities may withdraw a value based on individual compensation agreements. Municipalities may use these funds to settle of debts or invest in economic development. The ZMOS a similar success will result from lobbying for the compensation for investments in electricity distribution facilities. Municipalities are asking for compensation totaling about Sk 0.5 billion.

4.5 Utilization of Local Assets for Local Economic Development Actions

Municipalities have no significant options for influencing local economic development. As shown in Čapková's research (2001), they stimulate economic development mostly through rental of buildings and land plots. Municipalities also use the sale or donation of land plots, buildings, postponement of local tax payments, deductions in local taxes, as well as various forms of reliefs and waivers. Some municipalities invest in commercial enterprises or establish of enterprises themselves. Municipalities often prepare sites for potential investors in their territory, a high-investment activity. Municipalities have constructed industrial parks, but municipal financial funds are not sufficient for such projects. Additional financing must come from the state budget. On the other end of the scale, municipalities do not often issue loans to entrepreneurs or subsidies for commercial companies. Municipalities offer assistance in administrative tasks related to enterprising, favorable rents, consulting, promotional activities and start-up assistance.

Municipalities do not like to provide guarantees for entrepreneurs' credits. This is because municipalities would use municipal real estate as collateral, and there are not sufficient guarantees that supported activity will be profitable. In the first years of their existence, many municipalities had to take over debts on private companies and lost property. If municipalities decide to put their property at stake, they do so to support local production, increase employment, sup-

port food production, tourism, hotel renovation, protection and improvement of the environment, etc. Municipal investments can be secured in various ways—contracts, insurance, exchange of collateral after an investment is carried out and thorough supervision by the municipality. Often, however, municipalities do not take such measures to secure investments.

Even if municipalities are hesitant to support private companies directly, they are still willing to participate in economic activities. They form companies, with various forms of ownership and legal status. Almost 75% of municipalities with over 2,000 inhabitants possess at least one 100% municipally-owned company. 44% have shares in such companies. Contributory organizations account for the majority of 100% municipally-owned companies. Contributory organizations are municipal companies connected to the municipal budget through contribution transfer. Financial relations with the municipality are given in the municipal budget. Contributory organizations deliver public services that can be covered by fees, and municipal budget transfers only cover potential losses. Out of the total number of companies with municipal shares, almost 75% are directly connected to the municipal budget. This portion decreases as the size of the municipality increases. Large municipalities form commercial companies (limited-liability companies and stock companies) more often than small ones. As for employment, 75% of 100% municipally-owned companies are small enterprises with less than 25 employees. Only 5% of such companies have more than one hundred employees.

Municipalities also engage in commercial enterprises with multi-municipal ownership. Almost 17% of municipalities with over 2,000 inhabitants have a share in such companies.

Larger municipalities are more likely to contract private companies to carry out services for citizens. The reasons that municipalities use the private services are: lower costs, higher flexibility and the existence of a private company able to deliver the necessary services. Often, municipalities use both contributory organizations and private companies for provision of a single service.

4.6 Strategic Planning Regarding Municipal Property and Assets

The majority of municipalities do not have a realistic long-term strategy for economic development. Such a concept should include not only necessary investment and non-investment activities, but, above all, a draft arrangement of the economic structure of the municipality, including ownership and organizational and legal forms to ensure the per-

formance of municipal self-government functions. Due to this absence, municipalities often engage in inappropriate and uncontrolled activity. Problems with municipal waste, dilapidated real estate, public transport and housing, etc. have often caught municipalities unprepared. Solutions selected under pressure were rarely optimal. In what other way can the inadequate investments of cities like Kosice and Banská Bystrica be explained?

This lack is not only due to inadequate capacity of self-government officials, but also due to lack of adequate regulation, which would clearly divide the rights and obligations between state and local governments.

Čapková's research (2001) showed that less than half of the investigated cities (34) had elaborated and approved a long-term planning document. Most municipalities with over 2,000 inhabitants have master plans. However, these plans are often outdated, and municipalities update them only when a potential investor appears. According to the research, municipalities have no concept of municipal property use, no tax strategy for municipality development and no concept for support and development of entrepreneurship. In the future, municipalities plan to elaborate strategic documents to deal with municipal development as a whole, including systemic use of municipal property.

Local governments in Slovakia do not have sufficient experience in the elaboration of strategic and conceptual documents. This situation is mainly due to an unsystematic process of municipal staff education and training. For municipalities to elaborate and apply viable strategic plans, their staff must have certain knowledge and be capable of strategic thinking. More emphasis must be put on the proper definition of strategic issues and procedures. However, signs of change in this area can be observed. Several municipalities have recognized the advantages of systematic use of local assets for municipal development and have strategic plans for future development.

5. CONCLUSION

Property decentralization has been problematic, but continues in a positive direction. This paper has analyzed the timeframe of property devolution as well as its organizational and institutional framework. The laws and legal regulations related to municipal property transfer, use and management have been examined. Economic aspects of property decentralization, including scale, statistical information and the fiscal relevance of municipal property have been analyzed as well.

The years of transition have seen a continuous transfer of property and use of municipal property for improving the

financial situation of local governments. After 2001, the newly created self-governing regions instigated further transfer of state property to local government.

5.1 Failures of Public Property Transfer in Slovakia

The following failures can be cited:

- 1) Insufficient control mechanisms, mainly at the beginning of the process, to prevent conflicts of interest and favoritism (e.g., transfer of municipal property to relatives of local government representatives).
- 2) Following 1989, ownership settlements for nationalized property have not been adequately dealt with. Municipalities or regions often received state property that had been nationalized after the communist upheaval of 1948, and requests from the original owners have not been settled. Land crossed by roads or under schools cannot be returned. However, other forms of restitution can be applied (mostly financial). The original owner must file a request for restitution with the local government. It would be logical that these requests are processed by local administrations (the institution that nationalized the property to begin with), but as the properties have already been transferred to municipal ownership, such restitution issues remain the responsibility of municipalities.
- 3) The quality of legislation elaborated prior to transfer was poor, and laws were sometimes approved during or shortly prior to transfer. The trained staff in charge of decentralization became critical in this regard.

Regarding more recent property transfers, local government representatives identified the following problems:

- Preparation for the transfer of competencies from local administration offices was inadequate. Despite the fact the administration knew property would be transferred, no action was taken to properly document and regulate the transfer.
- Transfers were often laden with unsettled operational debts (often large unpaid utility bills). Utility companies threatened to shut off supply if debts were not settled. The law stipulates that the state (the central government) is to pay this debt. Municipalities, however, had no powers to force the state to settle its debts.

Further problems related to property transfer include: unresolved ownership relations, lack of property reports, insurance and problems related to facilities located on/in the restituted property.

The state of repair of buildings transferred to local governments was another concern. The so-called modernization debt totals several tens of billions of crowns—the result of poor management and lack of maintenance. The Laws on Municipal and Regional Property state that these debts pass to the local government. Regions feel the largest weight of this burden, as they did not receive the amount of property with freedom of use that was received by municipalities. How regions will raise funds to pay off these debts is still unclear.

5.2 Challenges in Public Property Transfer to Local Governments in Slovakia

In subsequent years, more competencies will be transferred to municipalities and self-governing regions than those already defined by the existing Competency Law. The lessons learned from previous transfers of competencies and property should be reflected in preparation for further transfers.

The issue of transferring state property to regions should be addressed in the near future. Regions currently have no property with which to form the financial basis of development. Property transferred to regions carries the huge ‘modernization debt’ that must be covered by the regions themselves. If the state was able to pass on responsibilities for transferred property, it should be obligated to create conditions for local governments to modernize and renovate old buildings. Instead, the state strictly limits local governments’ use of most recently transferred property (after 2002). Such limitations will have to be minimized in the future.

New laws cannot effectively address the problem of corruption and misbehavior in property management. Instead, current laws need to be enforced more vigilantly. The development of civil society could also help address this issue. Public awareness of civil rights and the competencies of local governments to use property must be raised by publicity campaigns.

Local government staff must be educated to think strategically, preparing and implementing strategic planning documents on property management. Sale, lease and other uses of the property should be systematic, with the use of such incomes clearly devoted to local/regional development.

5.3 Lessons Learned

The transfer of competencies and property was slowed by delays in public administration reform, lack of preparation and other complications (unresolved ownership relations, incomplete documentation, insufficient information on the

state of repair of buildings and facilities, etc.). Shortcomings in laws on the transfer of competencies complicated the accompanying property transfer.

Everything related to property transfer was somewhat chaotic. The scale of property transferred to municipalities over a decade ago is still impossible to quantify. This disorder ultimately points to poor performance by public administrators. Public administration bodies restructured property ownership several times during socialism and after 1989 as well, but the chaos in the public property registry was publicly visible for the first time only during privatization. Disorder was even more pronounced during transfer of property to local governments. During this process, complications in property ownership were also passed on to local governments. In the long-term, citizens will know which properties are private and which are public, which belong to municipalities, regions or the state. To define all the conditions of property transfer before the process begins is impossible. Certain properties must not be alienated by the state under any circumstances. Individual problematic cases can be left for later, when there is time to sort through them. Trying to fine-tune the conditions of transfer when process has already begun has proved fruitless.

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- The Constitution of the Slovak Republic.
- Law on Large-scale Privatization (92/1991).
- Law on Municipalities (369/1990).
- Law on Municipal Property (138/1991).
- Law on Operations in Matters of Ownership Transfer to Other Legal and Physical Entities (474/1990—the Operations Law).

Law on Protection of Cultural Heritage (49/2002—the Heritage Law).

Law on Regional Property (446/2001).

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Law on Small-scale Privatization (427/1990).

Law on Transfer of Founders' Functions from National Committees to Municipalities, Government Bodies and Local Administration Bodies (518/1990).

Law on Transfer of Selected Competencies from State Authorities to Municipalities and Self-Governing Regions (416/2001—the Competency Law).

Municipal financial statements 1990-2001

Schooling Law (29/1984).

NOTES

¹ For the purposes of this paper, “local government” refers to bodies of locally-elected officials enjoying some degree of financial autonomy; “local administration” refers to local branches of the central administration whose officials are appointed from above rather than elected.

² Small-scale privatization refers to privatization of small production, service and trade facilities. Large-scale privatization (organized by the so-called Law on Large-scale Privatization) refers to privatization of large companies, banks, etc. Large-scale privatization has not yet been completed).

³ The facilities relevant for municipalities that were excluded from the small privatization were under full ownership of municipalities (see section 3.1)

⁴ This included head-quarters of organizations, even if other units were located in an other municipality.

⁵ This provision has been indirectly amended; pre-schools, elementary schools and related facilities became the property of municipality in which they are located.

⁶ These liabilities have been partially paid by the state budget; the rest is to be paid from the same source.

⁷ Local administration bodies are authorized to make such a decision—in this case, the local representative of the minister of education.

⁸ This is mainly due to weak law enforcement and the sophisticated methods of corruption and fraud.

⁹ A provision concerning the transformation of state companies into joint-stock companies transferred a certain percentage of privatized shares to municipalities.

COUNTRY REPORTS

Charles Jókay

Policy Recommendations for Returning and Transferring Property to Local Government in Serbia



FROM USAGE TO OWNERSHIP

Transfer of Public Property to Local Governments in Central Europe

Policy Recommendations for Returning and Transferring Property to Local Government in Serbia¹

Charles Jókay

Since its inception in 2001, the work of the Serbian Local Government Reform Program (SLGRP) has been obstructed by state ownership of assets used by local governments. All key actors in the decentralization process in Serbia—representatives from central and local governments as well as members of international community—recognize this problem. Addressing this challenge, SLGRP, supported by USAID, in cooperation with the Local Government Initiative of the Open Society Institute (Budapest), agreed to help local stakeholders (especially the Standing Conference of Towns and Municipalities and the PALGO Center) in their efforts to put this issue on the Serbian government's agenda and provide analytical and advisory support. To meet these ends, studies were prepared by experts from Poland, Hungary, Slovakia and Latvia with the intention of documenting the experiences of these countries in the devolution of property to the municipal level from 1990 to 2002. The present paper is a summary of the experiences of transitional countries expected to join the EU on May 1, 2004, leading to specific political and technical recommendations for the Serbian government.

The recommendations this paper offers do not flow only from international experiences. They have also grown out of input from local experts and officials, including but not limited to: analysis prepared by local government officials from Nis, Krusevac and Aleksandrovac and by an official of the Serbian Secretariat for Legislation, comments heard on the Technical Conference on Property Devolution to Local Governments in Serbia (held on November 8, 2002 and January 29, 2003) in Belgrade, a number of interviews and focus groups with experts and officials on different levels of government.

The authors certainly recognize that the experience of the Central European countries are not always applicable to Serbia, and that stakeholders in Serbia, given their unique circumstances and initiatives already taken, must be given an opportunity to question, comment on, disagree with and finally modify this set of recommendations.

1. STATEMENT OF THE PROBLEM

Municipalities and cities in Serbia may “use” state property to carry out their functions. Local governments may use, enjoy the benefits of and make improvements to state property, but they may not sell or own property. Titles to assets acquired by local governments, in particular real estate, are issued in the name of the Republic of Serbia (RS), not the purchaser. The 1995 Law on Assets confiscated all other types of previous municipal property without compensation.

The Law on Privatization (2001) allots a 5% share of privatization revenues to both the autonomous province and to the municipality or city for infrastructure development if revenues are generated from the privatization of an entity headquartered in that jurisdiction. The privatization of an entity, such as a utility or a bank, which has many branch offices and production equipment in many localities, will lead to disputes.

Another 15% is distributed as compensations to private persons for nationalized property and endowments to the National Health Fund. The balance, 75% of cash proceeds, goes to repayment of public debt (see Article 60-61). The scope of privatization could apply to legal entities that are “socially owned” or “state owned...unless otherwise provided for in special regulations” (Article 3). The Privatization Law excludes “natural resources and goods in public use, as well as goods of general interest.” A definition of these exceptions is warranted, as communal enterprises and many other service-providing entities do serve public and general interest. Whether this excludes the use of public-private partnerships where state or “social” assets are combined with private capital is uncertain.

In accordance with the Law on Property Owned by the Republic of Serbia (*Official Gazette of the Republic of Serbia* 53/95, 3/96, 54/96 and 32/97), all residential accommodations that were “socially owned” and conferred to municipalities prior to 1995 were “nationalized” and have become state property. Nevertheless, municipalities were authorized to continue to dispose with housing units as they did before, without prior consent of the state agency (see Law on

Property, Article 50). In the previous ten years, during the privatization of state-owned housing units, municipalities had already sold almost all housing units.

On a constitutional basis, local self-government units do not own the property used in carrying out mandatory and delegated duties. The 1992 Federal Constitution (to be superceded by a new constitution of Serbia-Montenegro) does not list municipal or city property as a class of property, stipulating in Article 73 that “real estate and other property utilized by federal organs and local authorities and organizations performing public services shall be state owned, and the status and rights of these organs and organizations as regards the disposition of these assets and their utilization shall be regulated by law.” Article 56 of the 1990 Constitution of the Republic of Serbia identifies social, state, private and cooperative forms of property explicitly. Article 59 authorizes the Republic of Serbia to “transform social and state” property into other forms of ownership. Article 60 indicates that “urban construction sites,” unless they are privately owned, shall be owned by the state or are considered “social property.” The state is also the legal owner of local government service facilities, despite the fact that in most cases municipalities and towns were the primary investors in building and equipment of the municipal school buildings, local hospitals and social welfare institutions. The Law on Property Owned by the Republic of Serbia still regulates that issue.

Three options for resolving the constitutional obstacle have been proposed by various experts:

- a) Abolish the Law on Property of the Republic of Serbia;
- b) Amend the Property Law by allowing unlimited municipal authority over property they use, including the right to sell such property, with the state acting only as a formal owner;
- c) Wait for changes to either or both constitutions.

There seems to be a general disagreement among experts whether constitutional and statutory restrictions on municipal ownership—significant hindrances to efficient property management—could be overcome within the existing framework, avoiding the need for politically controversial changes to systemic laws.²

As of March 2003, no proposed legislation addresses the *return* of municipal/city property nor *transfers* of state assets to support new functions assigned by the 2002 Law on Local Self-Government. Serbia could benefit from the experiences from central governments in other transition countries that transferred property using a variety of legal bases in the early 1990s.

The first and most important step was to provide constitutional and statutory guarantees for property (both real and financial) that were in municipal (council) possession

upon transition (the equivalent in Serbia would be returning municipal and city property nationalized in 1995). In addition, transition countries such as Poland, Hungary and the Czech Republic assigned state enterprises, real estate and other assets to local governments prior to their transformation into limited companies and ultimate privatization. Proceeds from other privatized state assets that were not first transferred to the municipal level were partially paid in cash and state bonds. A final type of property transfer or compensation involved reimbursing local governments for ‘self contributions’ and other involuntary investments paid by residents for developing infrastructure—in some cases the actual capital costs of manufacturing facilities. In the case of Serbia, state asset transfers involve all of the above, in addition to the unique aspects of returning assets nationalized in the 1995 law.

1.1 Preliminary Conclusions

The most important conclusion of this analysis is not whether Serbia should return or transfer property to the municipal sector, but rather when and how to implement the devolution process.

Not only EU candidate countries have taken this step (often early in the transition process, as the accompanying texts show); all of the states of the former Yugoslavia are far ahead of Serbia. Slovenia and Croatia have already completed the process, with positive results. In Macedonia, the main issue is currently property balance between units of local governments. In the Republika Srpska, the second phase of the property devolution process is about to commence (transferring schools and other public institutions of local importance). In Montenegro, the government still has title to local property, but local governments hold the authority to manage it, including the right to sell without government approval. More information on the cases of Slovenia, Croatia, the Republika Srpska, Macedonia and Montenegro will be provided in Appendix I. Just by looking at neighboring states, it becomes apparent that a coherent system of local government property ownership does a lot for advancing asset management on the local level. As all developed countries, all transition countries in Central and Eastern Europe and all countries of the former Yugoslavia have introduced the right of local governments to own property, a logical conclusion is that there is nothing specific in the situation of Serbia that would justify perpetuation of this legal stranglehold.

Regarding the question of timing, the experience of other transition countries suggests that Serbia should act resolutely and swiftly. An important finding for this consideration is that it is not necessary (nor wise) to wait until denationaliza-

tion (returning property to individuals) takes place and property registries are updated before engaging in the devolution process. On the contrary, all transition countries undertook property transfers first, and many of them still have open issues regarding registries and denationalization. Concerning the third question—the methodology of property transfers, this paper offers several considerations that might be of use to future lawmakers.

2. THE EXPERIENCES OF FOUR CENTRAL EUROPEAN EU ACCESSION COUNTRIES

2.1 Why Pursue Property Devolution?

Professor Jerzy Regulski, the government plenipotentiary for municipal government reform³ in Poland in the early 1990s, argues that returning property to municipalities had an overwhelmingly positive effect.⁴ He writes:

Devolution of state property became one of the fundamental elements of the tremendous breakthrough that was municipal reform. Possession of property was a basis for local dynamic activity.

The Polish experience provides evidence that transfer of state property to local governments is a fundamental condition for effective decentralization. Without unrestricted ownership and asset management rights, local government would be unable to act effectively.

The entire devolution process must be done radically but very flexibly, as local conditions differ, and it is impossible to foresee all issues which will arise. The way in which devolution is organized and implemented has a decisive impact on the final result...

Devolution of state property to municipalities was the first, perhaps the only one-time operation on such a scale to reduce national property in Poland. Results were positive because the operation was conducted in a comprehensive and radical manner. The principle of transfer by law, as well as the organization of a system for negotiations and appeals limited biased decision, although they could not be entirely eliminated. The results are easy to see when traveling across Poland: the improving conditions of previously neglected villages and towns and the visible effects of owners' greater care for tidiness and order...

The most spectacular effects are to be seen in the field of local infrastructure. The infrastructure inherited by the new local authorities were frequently in an awful state of disrepair, making residents' lives difficult and restraining opportunities for economic development. Infrastructure development became a municipal priority. The previous bureaucratic system of investment and development was eliminated and a new system was launched, based on market mechanisms. Sensational results were achieved. Table 2 shows the development of sewage and water supply systems. The great improvements were the result of work performed by municipalities, owners of more than 90% of water and sewage facilities.

2.2 What the Example Countries Have in Common

Each of the four studied countries offers a unique set of good and bad experiences; no country alone provides a perfect example for Serbia to follow. The outcome of property transfer to the municipal sector was positive. The results common to all four example countries is that genuine real estate markets emerged; the mentality of municipal stakeholders changed to that of owners with responsibilities to future generations; local resource use became more efficient, and, combined with new state programs, an "infrastructure explosion" occurred in environmental services such as water, wastewater management, solid waste services and other linear services such as public heating, lighting and in some cases telephone services. Municipalities were able to sell property that would be more effectively used by private entities, or which were financial burdens. Proceeds from sales were then reinvested in new infrastructure and used for the rehabilitation of business districts etc.

Commonalities are as follows:

- Restoration of municipal property rights was a part of a greater "package" of democratization begun immediately on transition to democracy.⁵ It took place in an atmosphere of overall consensus among parliamentary parties. In other words, the issue of whether to restore municipal property rights and to create a self-government system was not significantly disputed. The decision was a fundamental part of the democratization process.
- Restitution and compensation for nationalized property (of natural and legal persons) was not a prerequisite for the devolution of property to local self-governments. Denationalization was dealt with separately in the form

of constitutional amendments or laws. Potential claims against the state or local governments were handled through the courts, by regulation and special procedures.⁶ Municipal property was not returned to individuals.

- Constitutional and/or systemic laws in each state proclaim that municipalities have the right to own property and to exercise all the rights of ownership, including the right to purchase and sell property.
- Constitutions and higher order laws in all four example countries guarantee that municipalities shall own at least those properties needed for the completion of mandatory functions. If new functions are assumed by or delegated to municipalities, there are laws to guarantee that sufficient property and recurring funds will be provided.
- Most property was returned and transferred to local self-governments quickly—immediately upon passage of critical legislation. In some cases, specialized property like regional infrastructure providers and other state enterprises were transferred in follow-up legislation. The majority of property was transferred at once early in the reform process.

2.3 How They Differ

To differing degrees, each country had not only to restore municipal property nationalized by communist regimes, but also consider the transfer of other properties needed for the performance of new functions assigned to municipalities after the transition to democracy.⁷ In some cases, assets and properties built with state, cooperative or ‘voluntary’ self-contributions were given to municipalities outright. The four states diverge in how state enterprises were privatized, with varying degrees of compensation to municipalities.

The transformation into corporate entities and the ultimate privatization of regional infrastructure services such as natural gas, electricity distribution, water and waste management led to a decade of lawsuits and supreme court cases in Hungary, while other states used different methods to compensate municipalities for their ‘moral share’ of these strategic enterprises.⁸ Poland did not initially compensate municipalities for their contributions to infrastructure companies. Instead, these regional firms were broken up, corporatized, and compensation schemes were developed afterwards. The natural monopolies in Slovakia were partially privatized in 2002, with compensations claimed by municipalities in the gas and electric sectors (compensation was only paid in the gas sector).

In Poland, communal service companies that serve many municipalities were first reorganized and broken into new

entities before being transferred to municipalities served by the original larger firm. In Latvia, enterprises and companies providing water supply, sewage services, central heating and street lighting were transferred to municipalities. Power supply, gas and telecommunications companies were established as state-owned enterprises and have been privatized gradually. In view of the small size of Latvia (total area of 64,000 sq. km), establishing such municipal enterprises was deemed economically ineffective.

Each country developed methods to prevent the squandering of former state property by municipalities. Hungary used a complex but efficient system of classification to protect public property and the mandatory tasks of municipalities, while giving municipalities unfettered freedom to manage non-essential assets in a manner similar to commercial entities. In the Hungarian system, properties serving mandatory purposes are defined as “core assets” that cannot be sold or mortgaged. However, there are provisions for reclassifying core assets, if, for example, a school is closed due to declining population. Reclassified property, along with non-core property such as construction land and commercial buildings, may be freely sold, invested in projects, mortgaged and otherwise utilized as a revenue source for municipalities. In the Hungarian system, as municipal tasks change, or demographic trends encourage reorganization, even protected assets may be reclassified for use in a more efficient manner. Latvia requires that revenues from asset sales be used to conduct mandatory tasks, while Poland relies on the service provision obligation to leverage municipalities into efficient use of revenues from asset sales.

The legal bases and devolution procedures were different in each country, involving varying degrees of administrative fiat or decisions involving negotiation among varying levels of government.

3. POLICY RECOMMENDATIONS FOR SERBIA

Before attempting to make specific policy recommendations for Serbia, we must emphasize that the national legislature and executive branch must make several critical decisions. These decisions and guiding principles should be enshrined in a public and transparent manner before difficult technical and administrative procedures are put into place to start a process that will take years to complete. These legislative, administrative and technical recommendations assume that a consensus-based political decision can be made to support the following seven principles.

The highest-order political principles that need to be made clear to all stakeholders are the following:

- 1) Democracy, decentralization and ultimately EU accession status are difficult to achieve without the restoration of full property rights to municipalities and cities. This includes the right to buy, sell, use and otherwise manage property, as is the case with any private owner.
- 2) Denationalization of property taken from individuals will not affect municipal property restitution since property used or to be returned to municipalities will not be returned to individuals. Instead a separate set of laws will offer compensation to private persons with claims on municipalities.
- 3) Original municipal property shall be returned before a certain date (to the fullest extent possible) based on a new law (or constitutional amendment). Original municipal property could be defined narrowly as those properties and assets needed to perform current mandatory tasks, or in a broader sense, those properties (in addition to the above) that are being currently used by municipalities but owned by the state. This definition must be agreed on prior to the return of property.⁹
- 4) A higher order law or constitutional amendment must guarantee that future tasks assigned to municipalities and cities will be accompanied by relevant resources, including financial resources and real property.
- 5) State, social and communal property¹⁰ to be returned or retained by the state must be clearly identified before their corporatization and potential privatization begins. This is especially important in the case of infrastructure such as electric and natural gas distribution and telephone networks. In other words, future ownership of these types of assets should be clearly designated in advance to preempt future claims on the state.
- 6) Municipalities must be given or at least compensated for their self-contributions¹¹ and local funds used to construct socially and state-owned property within their territories (this compensation may take place after privatization, but the amount or share to be given to municipalities should be clearly stated in advance to avoid future disputes).
- 7) Clear procedures should be announced in advance for resolving disputes between the state and conflicting claims among municipalities.

3.1 What Should Be Transferred

Recommendation 1

We suggest a combination of the functional and categorical approaches to transferring property to Serbian municipalities and cities. These approaches are detailed below.

- *The Functional Approach*

The state returns and/or transfers only property needed to carry out mandatory municipal and city functions defined in the Law on Local Self-Government (some property currently “in use” may be retained by the state). The functional approach, to be defined perhaps in the Constitution, should follow the *subsidiarity* principle, in that all the assets connected to the assigned local government functions should be transferred immediately upon passage of amendments to current laws (the present and future usage of assets is what matters).

- *The Categorical Approach*

Types of property are transferred that should categorically belong to local governments if they are not already in private ownership or soon to be privatized, or are being used by institutions carrying out functions on behalf of another layer of the state. These properties should not be listed by cadastre number, but by type and use (including property not currently ‘in use’ or not currently serving an essential task). Sequence: in Slovakia, decentralization of some functions (such as elementary education) happened *after* property transfer protocols were signed with each recipient. Basic, organic municipal property was returned many years *prior* to decentralization of all functions.

Examples of categories, not all-inclusive, from Hungary, Poland, Slovakia and Latvia: land, water-flows, natural resources, public spaces (parks, streets, squares, etc.), service organizations (health, education, welfare), urban infrastructure, social housing units, urban land (construction land), state-owned enterprises founded by the municipality, financial assets, intangible assets (rights, contracts, etc.).

A special category, reinforced by many Serbian municipal officials, is: assets built entirely or with significant self-contribution taxes and other local resources (either entirely municipal ownership suggested or generous compensation if the state retains temporary ownership to prepare the asset for privatization.)

Jerzy Regulski suggests that each category needs a different set of procedures and criteria. His categories are: real estate (land, buildings and infrastructure), enterprises and institutions (schools, etc.), intangible assets (rights and obligations) and financial assets and debts.

- *Restoration of a Certain Status Quo Ante*

The restoration of a certain legal status quo ante—ownership as of a certain date (1995)—may generate disputes between municipalities as current or past users of state property, as well as excessive claims by municipalities. A ‘blanket’ cancellation of the 1995 Law on

Assets must be reinforced by the two principles cited above.

In this case, it is necessary to consider:

- Many properties may have changed owners, changed legal form (transformation or privatization of enterprises) or be legally unregulated.
- Authorities will be anxious about the fate of property not essential to local governments for the performance of their functions. Therefore, a mechanism to ensure that property is not wasted will be essential.
- *The Compromise Solution (Suggested by Regulski)*
The state returns property currently managed by local administrations, with some minor corrections. That is, the state retains property essential to its functions and devolves properties that were in local hands in 1995. Local governments may claim additional properties from the regional level if they serve new municipal functions prescribed by law.

Recommendation 2

The solution for property transfer is *not* only to restore the 1995 status quo by rescinding the Property Law.

Talis Linkaits of Latvia strongly suggests the functional approach, and rejects a mere restoration of a status quo that may by itself not be optimal: “The functions of local governments should be reviewed and precisely defined. The property transfer should be related to the functions of local government, not to the restoration of the pre-1996 situation.”

3.1.1 Urban Land

Recommendation 3

Urban land must be included in the property transfer process, or compensation methods¹² need to be developed before the restitution process begins, to avoid a decade of lawsuits as happened in Hungary. In addition to this, an amendment to the Constitution should be introduced with the purpose of abolishing the provision stating that all urban land is the property of the state.

3.1.2 Natural Regional Monopolies and Communal Service Enterprises

Recommendation 4

- The state must announce in advance how municipalities will share (if at all) in the privatization of natural monopolies such as regional gas, electric, telephone, water companies etc. One principle would be to com-

pensate municipalities for the value of the land and other assets they ‘contributed’ to the establishment and expansion of these utilities within their own jurisdiction, including self-contributions.

- Communal enterprises that serve a specific municipality should be the sole property of the municipality served, including state-owned or established enterprises that provide public services to the territory of a municipality.
- Industrial enterprises and public utilities that provide services to regions or to the whole country should not be transferred to local governments.
- The state must develop a method to allocate ownership among several municipalities if a regional communal enterprise serves more than one municipality.

3.1.3 State-owned Enterprises Located on Municipal Land

Recommendation 5

Compensation should be paid to local governments when state-owned companies located in a municipality’s territory are privatized (the 5% principle applies in Serbia).

In Hungary, local governments did not make a material contribution when companies were established (in certain situations they contributed the land), but have an economic interest in the functioning of the company whether owned by the state or individuals. There was a general principal established in Latvia that the municipality receive 10% of each privatization transaction performed by state institutions (irrespective of the nature of the privatized business). As can be seen in the Latvia country report, privatization revenues formed an insignificant part of local budgets (less than 5% of the total revenues of the municipalities). On the other hand, the state received the same percentage (10%) of the each privatization transaction performed by the municipalities.

3.2 What Should Not Be Returned or Transferred

Recommendation 6

The types of property, enterprises, communal service and public service, as well as utilities that will not be returned or transferred in whole or in part to the municipal sector must be defined by law or decree. Regulski suggests the following exemptions: properties that serve public functions that fall within the competence of central administration, courts and state authorities; state enterprises and utilities that exercise regional and national functions; national agricultural property.

Not all types of property were returned or transferred in the countries analyzed here. Various laws followed the initial restoration of property rights upon transition to democracy in 1990–1991. Examples follow:

- *Hungary*: gas, electric and phone companies were not transferred. These public utilities had not been owned by local governments nor managed by councils.
- *Latvia*: certain types of property were excluded from transfer. Power supply, gas and telecommunications companies were historically established as state-owned enterprises and have been privatized gradually. In view of the small size of the country (total area of 64,000 sq. km), establishing such municipal enterprises was deemed economically ineffective.

3.3 Resolving Disputes and the Issue of ‘Unwanted’ Properties

Recommendation 7

Disputes, if any, that cannot be settled by law, should be handled on a case-by-case basis with a type of commission or committee formed by the state, province or municipality, where a court or perhaps a supreme elected body has the final say (all four reference countries formed committees and established legal procedures to deal with disputed claims).

Recommendation 8

Municipalities should have the right to refuse ‘unwanted’ property (heavily polluted military or industrial land for example). The burden of maintaining and cleaning up such property should not fall on the municipality.

In accordance with the principle of subsidiarity, an owner must be found in a higher level of local administration or even in a different sector of public administration. The more complex question is what to do if unwanted property is connected to a mandatory function of local government. A piece of public property cannot remain ownerless. As a general principle, if a transfer is refused, the property stays with the original owner, that is, the state.

Recommendation 9

Certain properties must be privatized. A proper scheme to share in privatization revenues with transparent rules must be defined in advance.

3.4 Changing the Legal Framework

Recommendation 10

- Property rights for local governments should be established in the Constitution, and then adjusted through

subsequent legislation. Some federal laws (laws on enterprises and bankruptcy, etc.) will be re-approved as Serbian laws. In this case, the ministry of public administration and local government and the Standing Conference of Towns and Municipalities should monitor the legislative process, making sure that local government interests are properly served.

- Systemic laws such as those decentralizing government functions should be enacted over a short period of time. Serbia should enact changes to the Property Law and Local Government Law simultaneously. Property restitution to municipalities should be included in these laws (as in Poland, Hungary and Latvia).
- Most property returns should go into effect on the same day.

Recommendation 11

Properties to be transferred to municipalities should not be the subject to restitution to individuals or businesses. Properties given to municipalities need to be exempted from restitution claims during the denationalization process. Municipalities should not pay compensation to private persons—the state should.¹³

3.5 Additional Elements of the Process

3.5.1 *Identifying a Competent and Authorized Agency*

Recommendation 12

- The property transfer procedure should be described in the law. The state institution responsible for implementation (the ministry of public administration and local government or a special agency controlled by the ministry) should be named.
- General guidelines should be prepared by the responsible institution and approved by the government.

3.5.2 *Inventories*

Recommendation 13

Do not wait for specific and complete lists of properties and assets to be completed before transferring property based on current and future functions, compensation for self-contributions or subsidiarity principles.

Regardless of the path chosen to return to the status of 1995 or transfer property linked to local government functions, it will be essential to conduct an inventory. This is a difficult task, demanding time and capability. Therefore, it

is recommended that administrative procedures for such an inventory be developed. The following must be defined:

- the manner in which the body taking inventory is formed (a commission formed by the local government or a mixed commission of local government representatives and local representatives of the national government or employees would be advisable; it is important that the staff conducting the inventory possess the proper level of administrative ability)
- the manner of the commission's work, dates for preparation of a protocol and the level of detail of each list/protocol;
- rules for including a property in the inventory;
- a central government body which provides the legal basis for transfer of property through approval of the inventories;
- appellate organs, in the event that a local government disputes elements on the list (this may be a joint commission at the national level or the administrative court);
- competencies of each organ involved.

Moreover, procedures and resolutions should define the date upon which property transfer goes into effect. Because the preparation of an inventory is not easy, commissions should be trained. The timeline for the entire process should be established so that once procedures have been developed, adequate time and resources are available to conduct training at the local level. Due to the number of local governments and components of property, the entire process should be decentralized so that central government bodies deal only with appeals, in other words unclear issues. It is also important to ensure that decisions approving the list obligate registration bodies to register local government ownership.

3.5.3 Property Transfer Committees

Recommendation 14

Procedures and powers must be defined, with intergovernmental commissions working with citizens to oversee the transfer process, negotiate disputes, provide local governments with information etc.

Property transfer committees created lists of properties within a unit of territorial government based on instructions in various laws. Polish *gminas* created lists based on laws, functions and local tradition, and submitted these inventories for approval by a higher level of government—the voivodship. In Hungary, county committees were temporary administrative bodies not directly controlled by local governments. Municipal representatives were not allowed to be members of the committees. The 13 committee-members included a president and deputy designated by the min-

ister of the interior on the basis of the government's delegation with the approval of the ministers concerned. Representatives of local governments served as observers and commentators. In Slovakia, joint inventories were created within public administration.

Recommendation 15

Administrative support must be provided for commissions and local government staff. County property commissions must have their own administrative staff. In Hungary, lack of staff made commission operations cumbersome. Commissions had authority with no administrative support, and there was no legal relationship between the decision-maker (the commission) and the municipal staff who volunteered to prepare the inventories.

Local governments, particularly in smaller settlements, do not have the administrative background to manage property transfer. Consequently, it is convenient to provide professional, financial and material assistance to the management over the course of the procedure. Assistance to the central administration is necessary to assure the following:

- 1) procedural uniformity;
- 2) legality;
- 3) professionalism;
- 4) coordination between different organs of public administration, including coordination between local government and local public administration;
- 5) balance between public good and special interests.

Recommendation 16

Local government staff must be trained. In Hungary, municipal administrative personnel were not trained in preparation for their new functions as property managers, nor were they prepared for executing the transfer process.

Preparation includes personnel and organization not only at the local government level. Local governments must prepare for the vast array of management-related tasks. This can be understood when considering the range of local government functions as well as property necessary to their fulfillment. The capacity of the land registry office is likely to be problematic. It is likely that without any preparation, the office will not be able to cope with the task. In Hungary, larger numbers of civil servants should have been employed focusing only on the process of registry.

3.5.4 Transfer Protocols

Recommendation 17

Do not use transfer protocols for the one-time, first wave return of property (Slovakia experienced problems with bad technical conditions, refusal to sign protocols, unsettled resti-

tution claims, as well as resistance and delays from public administration). Protocols give too much arbitrary power to local public administration bodies legally capable of sabotaging the overall goal.

In Slovakia, administrative and functional decentralization took place in phases, and transfers by protocol negotiated between municipalities and public administration took place only in the second wave of property transfer (2002). These protocols included definitions and value estimates, rights and responsibilities, cadastre information, as well as necessary costs of repairs. Given the much smaller scope of property being returned (no environmental infrastructure), this procedure is not practical for a massive transfer of property. The process took place as follows: the Law on Decentralization of Competencies was adopted defining the exact dates of competency transfers. The transfer of competencies was directly linked to the transfer of property. As the dates of transfer approached, protocols on the transferred property were prepared. Municipalities were obliged to sign the protocols within a certain time after the date of transfer.

3.5.5 Conflict Resolution

Recommendation 18

Public administration staff at the municipal level, and at any level that takes part in the transfer process, such as in committees or commissions, need training before starting the process of property transfer.

3.6 Suggestions for Municipal Property Management

3.6.1 Property Classifications and Protection of Public Assets

Recommendation 19

Decide who has responsibility for funding maintenance, repairs and new capital projects once ownership is transferred. Is the state ready to provide capital improvement funds?

3.6.2 Sales of Assets

Recommendation 20

Proceeds from the sale of municipal assets such as buildings, construction land, apartments, commercial property, shares in enterprises, enterprises etc. may only be used for capital investment projects and may not be used to fund maintenance, operations, salaries or other recurring expenses.

Restrictions on the use of capital income and revenues from sales of capital assets are common in OECD member-countries. Capital income and sales revenues may only be used to fund capital expenses, or municipal assets may not be sold at all as by definition there are no 'excessive' municipal assets beyond what is needed to perform mandatory functions. Hungary and Poland demonstrate an extreme permissiveness, i.e. there are no restrictions on the use of funds from asset sales. In Latvia, proceeds from sales of property may only be used for mandatory functions; in Slovakia, proceeds may only be used for capital investment.

The uncontrolled sell-off of assets may be insured against through the classification of property and limitations on the freedom of control (especially of sale) over certain types of property. Moreover, budget law may limit the use of revenues from sale of property to capital investments. In this manner, it will not be possible to sell property in order to 'consume' monetary sources (spending on current issues).

Regardless of whether greater or smaller limitations are placed on the sale of assets by local governments, it is important to ensure proper asset management. In particular, it is recommended to:

- Ensure proper local public control over the sale of property, e.g., through the requirement to obtain the approval of the local council for sale of property.
- Ensure proper and independent assessment of property intended for sale.
- Ensure the existence of competitive procedures (similar to public tender) in the sale of property.

In cases of particularly sensitive categories of property, the requirement to obtain the approval of the central government for sale may be introduced. Moreover, effective property management should also include reporting. It is suggested that the reporting system be linked to the procedure for budget approval and reporting. A consolidated report on the state of communal property, in particular providing information on changes in property (purchases and sales) and, even better, also changes in property values, should be submitted together with the budget. The report should be available to the local public and collected by the central government administration for review and controlling purposes.

Recommendation 21

The auditing and accountability standards for municipal property management should also be developed as property is transferred to the municipal level. Record keeping, book-keeping, accounting, controlling and auditing procedures regarding municipal property should be clear and developed to go into effect as property is returned or transferred.

4. JUSTIFICATIONS FOR RETURNING AND TRANSFERRING PROPERTY TO MUNICIPALITIES

Besides the principles cited above, there are several other reasons to return and/or transfer property to territorial self-governments. These are justifications in addition to legal, constitutional and historical/traditional arguments.

1. *Local economic development and the creation of a real estate market:* Local governments have limited interest in investing and developing local infrastructure if the ownership rights will belong to someone else (the state), especially in a situation where the state can sell it without municipal approval. If municipalities cannot offer shares in cash or in kind, they will be hindered in obtaining matching funds from donors and attracting private capital in the interest of creating jobs. Municipalities,

as in Croatia and elsewhere, could use their real estate portfolios for economic development, and earn rental income to fund operations or improve citizen services.

- 2) *The subsidiarity principle:* In the EU, systems are designed to operate on the principle that political and economic issues should be addressed at the lowest possible level—the level closest to the citizen. Thus, issues such as primary education, basic health care and public lighting are controlled by local governments most closely connected to the beneficiaries of these services, who oversee the quality and quantity of public services being offered.
- 3) *Restitution:* It is imperative to restore previous rights and properties to local governments hindered during the Milosevic years. More importantly, it is natural that assets built by contributions from local governments and citizens should belong to municipalities.

ANNEX

The Experiences of Slovenia, Croatia and Macedonia

Each of the former Yugoslav republics has restored a certain scope of property rights to local governments. Property rights and the benefits of property ownership and management are defined in constitutions, laws on self-government and special laws on budgeting, economic activities and municipal finance. Key provisions and the sources of these laws are briefly highlighted below:

Slovenia

The Law on Local Government, first adopted in 1993 and amended 7 times by 1999, established a system of new self-governments that abolished the principle of social ownership and introduced a pluralist model of ownership in a market economy. Local governments are financed in accordance with the 1994 Law on the Financing of Municipalities, amended in 1998. The Finance Law detailed the financing of mandatory tasks and financial equalization. Municipal assets consist of movable and immovable property, financial assets and rights. The value of such assets is stated in the balance sheet of assets, approved by each municipality in accordance with the law. Municipalities manage the following property:

- land (developed, vacant or agricultural) acquired by a municipality through payment or by other means;
- municipal infrastructure (roads owned by the municipality, waterworks, hot water supply, gas supply, etc.);
- housing (subsidized and non-profit municipal housing);
- commercial space (available for rent to commercial and non-commercial entities);
- capital shares (in public companies, public institutions, commercial enterprises, banks, etc.);
- financial resources from the budget, public funds and agencies;
- other financial resources (deposits, securities, etc.).

The municipality must manage all its property in line with sound economic principles. The disposal of municipal assets is possible only against payment, unless the assets are donated for humanitarian, scientific, research, educational or similar purposes. The Municipal Council is the body competent to decide on such disposal. A municipality may manage its property the following ways:

- 1) Manage it on its own through a municipal administration office; establish a public fund to which it transfers a certain kind of property for management (e.g. housing funds manage housing and business premises).
- 2) Establish a public institution to manage a certain kind of property (e.g. a public institution for the management of building sites in cities).
- 3) Establish a public enterprise or public commercial institution to manage certain types of property (public waterworks, sewage, waste disposal, maintenance of municipal roads, etc.).
- 4) Grant concessions to natural and legal persons for the management of certain types of property.

Article 7 of the newest version of Slovenia's Law on Local Government (70/2000), states that "self-governing local communities shall be public legal entities with the right to possess, acquire and dispose of all types of assets." Article 51 of the law declares that municipal assets are intangible and tangible property owned by the municipality, including rights. Article 21 states that asset management is one of primary duties of a municipality.

Article 51c of the law defines what types of property belong to municipalities. An excerpt is reprinted below:

- Every municipality shall become the founder of public institutions and shall assume the rights and obligations to public institutions and contractors carrying out, in accordance with the public service network, activities that the municipality must provide, only on the territory of this municipality and only for its inhabitants;
- Municipalities shall become co-founders of public institutions and shall together assume the rights and obligations to public institutions and contractors carrying out, in accordance with the public service network, activities that the municipality must provide in the entire territory and for all inhabitants of the previous municipality. Each founder shall have the right and obligation to provide, by common public institution, concession contract or another contract, the execution of activities in its territory and to take part in the management and responsibilities toward the public institution, concessionaire or contractor in proportion to the number of its inhabitants or the inhabitants of the territory that joined this municipality in the entire number of

inhabitants of the previous municipality for whose territory the public institution had been founded, or for which a concession or another type of a contract had been concluded;

- Every municipality shall become the founder and owner of public capital in public companies, public funds and agencies that was the property of the previous municipality, or enters a concession or another contract as the only contracting party if the public company, public fund, agency, concessionaire or another contractor carries out a public service and other tasks in accordance with an act or regulation of the previous municipality exclusively for this new municipality's inhabitants of exclusively in the territory of this municipality;
- Municipalities shall become co-founders of public companies, public funds and agencies that were founded in order to carry out public services and other tasks in accordance with an act or regulation of the previous municipality for the territory of the previous municipality, and enter in concessions or other contracts and jointly assume the rights and obligations toward public companies, public funds and agencies, concessionaires and other contractors. Each founder shall have the right and obligation to ensure the carrying out of activities in its territory by way of a joint public company, public fund, agency, concession or another contract and to co-operate in the management and responsibilities toward a public company, public fund, agency, concessionaire or contractor in proportion to the number of its inhabitants or the number of inhabitants of the area that joined the municipality in entire number of inhabitants of the previous municipality for whose territory the public company, public fund or agency was founded, or a concession or another type of a contract was concluded. The same proportions shall be used as the municipalities shall become the owners of ideal shares of public capital of a public company, public fund or agency that was the property of the previous municipality.

Croatia

According to The Urban Institute, an American advisory NGO active in Croatia, Croatian municipalities own substantial assets, including real estate:

Real property portfolios in Croatia contain very diverse properties. The major characteristics of these portfolios, both in Croatia and in other transitional countries, are as follows:

- Rapid devolution of property made many local governments the largest property owners in urban areas.
- Large real estate portfolios are being transferred from direct ownership into ownership by enterprises that are owned by local governments.
- Fiscal concerns prevent for further privatization.
- Large portfolios of social or core services properties with negative cash flows are being transferred to local governments.
- Large portions of portfolios are obsolete properties with negative residual value.
- Real estate amounts from 50 to 95% of the total value of local government assets.
- Most local governments have no inventory of physical assets, and even more rarely an accounting of the value of these assets.
- A clear understanding of assets and liabilities is a precondition for moving forward intelligently with financial management in local governments.
- As in most of countries in the world, public real estate is one of the most underutilized local resources.
- There is a need to establish appropriate standards of accounting and reporting public property.

Revenues of real property assets in Croatia on average bring in 8% of local governments revenues. This is the fourth largest source of revenue, after personal income tax, taxes and fees, and enterprise taxes. Deviations among local governments are significant, in absolute terms and as a percentage of local revenues, from 1.3% to 25.3%.¹⁴

The legal framework supports the situation described above. The Law on Local Government and Administration (1990, amended 1999) indicates that municipalities are legal persons (Article 8). As legal persons, municipalities own moveable and immovable property—they are full owners with all rights and obligations (Article 67). Municipalities may also generate income through property management (Article 68).

Using the functional approach, the 2000 law on Municipal Economy defines mandatory municipal services (Article 3) and that concessionaires, municipal enterprises, or private firms may perform most of these services. These municipal activities are:

Article 3

(1) In the sense of this Law, municipal activities are:

- 1) drinking water supply;
- 2) wastewater drainage and purification network;
- 3) gas supply;
- 4) heating supply;
- 5) public transport;
- 6) maintaining of cleanliness;
- 7) municipal waste disposal;

- 8) maintenance of public surfaces;
- 9) maintenance of unclassified roads;
- 10) retail sale markets;
- 11) maintenance of graveyards and crematories, and performing funerals;
- 12) chimney sweeping;
- 13) public lighting.

What is most important is that enterprises which perform services on the territory of a municipality, including those formed with social capital, are transferred to municipal ownership. Article 31 of this law is cited here:

Adjusting the work of legal entities with the provisions of this law:

- (1) The social capital of legal entities registered to carry out of municipal activities on the date this law comes into force become the joint owners of units of local self-government organized in the territory of the former municipality according to the seat of the legal entity.
- (2) The Croatian Privatization Fund is obliged to transfer stocks from joint-stock companies, arisen in the realization of the provision in Article 3 of the Law on Amendments and Supplements to the Law on Transformation and Organization of Companies Engaged in Municipal Activities and Activities of Arrangement of Settlements and Spaces, Transport of Passengers in City and Commuter Traffic, and Activities of Arrangement and Maintenance of Retail Sale Markets to joint ownership by units of local self-government organized in the territory of the former municipality according to the seat of the company within 3 months of the date this law enters into force.
- (3) Companies that did not act in accordance with the provision from Article 3 of the Law on Amendments and Supplements of the Law on Transformation and Organization of Companies Engaged in Municipal Activities and Activities of Arrangement of Settlements and Spaces, Transport of Passengers in City and Commuter Traffic, and Activities of Arrangement and Maintenance of Retail Sale Markets are obliged to transfer the stocks to joint ownership by units of local self-government organized in the territory of the former municipality according to the seat of the company within 3 months of the date this law enters into force.
- (4) Social capital defined in Paragraph 1 and stocks defined in Paragraphs 2 and 3 of this Article will be divided by units of local self-government in mutual agreement within 6 months of the date this law enters into force. If an

agreement cannot be reached, the provision from Article 87, Paragraph 2 of the Law on Local Government and Administration will be applied.

It is apparent that Croatian municipalities may own property and have received ownership of many formerly state, social and joint-stock enterprises.

Macedonia

Article 5 of the 1995 Law on Local Government declares that municipalities are legal entities. In addition, municipalities may own land, facilities etc., to the extent that they have been financed by self-contributions (Article 60) or through other ways of participation. Funds earned through disposal and management of property may be used for refurbishment or purchase of additional property. This definition is much more restrictive than in the case of Slovenia or Croatia. New units of self-government (Article 61) are to receive property defined in a distribution statement signed by the Republic and the old and new unit of self-government. Finally, property may be used to generate local revenues (Article 62). Even in this modest scenario, assets built with self-contributions are municipal property, and new property may be acquired and fully owned.

Montenegro and Republika Srpska

Montenegro and Republika Srpska are also far ahead of Serbia in terms of property rights of local governments. In Republika Srpska, an initiative was launched to devolve property rights on schools, medical centers, etc. If this goal is achieved, it will constitute a second stage of property transfer in Republika Srpska.

In Montenegro, the situation is still rather complex, but some steps have already been taken. Namely, while the state still holds the titles to property, local governments in accordance with the Law on Property, have the right of disposal, including the right to purchase and sell property without approval from a state agency.

Except Serbia, all countries of the former Yugoslavia have progressed regarding local property management and ownership. All transition countries in Central and Eastern Europe have provided local government with the right to own property. There is nothing to specific to the situation in Serbia to justify a failure to enact similar measures.

NOTES

- ¹ This document is primarily based on the studies included here as well as commentary by Gábor Péteri, Dušan Vasiljević and Zsuzsa Kasso. All authors contributed policy suggestions and general conclusions. Charles Jókay is fully responsible for any mistakes or misrepresentations.
- ² Amending the Federal and Republic Constitutions: Amending Article 73 of the FRY Constitution required submission of a petition signed by at least 100,000 voters, or 30 deputies from the Chamber of Citizens (lower house) or 20 deputies from the Chamber of Republics (upper house). Amendments may also be proposed by the federal government. Both chambers require a two-thirds majority to pass amendments. If an amendment fails, it may not be resubmitted for a year. Amending the Republic Constitution (see Article 132) requires a petition signed by at least 100,000 voters, or the support of 50 representatives in Parliament. Two-thirds of the government or the president may also propose constitutional amendments, which can be passed by a simple majority in parliament. The Constitution is changed if a majority of voters supports an amendment through referendum, on the condition that turnout is more than 50% of registered voters in the Republic of Serbia.
- ³ These comments were made by Professor Regulski at the Technical Conference on Property Devolution to Local Governments in Serbia, held in Belgrade in November, 2002, organized by the Standing Conference, SLGRP, the PALGO Center and the Open Society Institute's Local Government Initiative.
- ⁴ See Mr. Regulski's paper, "Devolution of National Property to Local Government in Poland," which also includes a complete outline of the benefits of property devolution to local government.
- ⁵ In some cases, the transfer of property and new responsibilities took place years after the original systemic laws were put into place, as was the case with elementary schools in Poland and Slovakia.
- ⁶ In the case of Hungary, the Local Government Law and the Law on Property Transfer stated that property transferred to local governments could not be transferred to individuals. This meant that property given to municipalities could not be the subject of claims by individuals, who were compensated under a different law. These properties were never to be transferred to others in specie. In Slovakia, up until 1992 citizens could claim restitution for property transferred to municipalities. These properties could not be sold by the municipality if a claim had been filed (compensation was paid by the state).
- ⁷ It is interesting to note what was not returned at the moment of transition to democracy. In Hungary and Latvia: gas, electricity and telephone companies. In Slovakia: water, wastewater systems and enterprises (transformation began in 2002); elementary schools (functions and schools were transferred in 2002). In Poland: regional infrastructure enterprises prior to their breakup.
- ⁸ 'Compensation' should not be taken literally. In this context, municipalities received a share of ownership in the transformed enterprise before their privatization. Or municipalities could receive a fixed share of privatization revenue based upon their historical contribution of land, labor or cash used to build the local portion of that infrastructure.
- ⁹ It is theoretically possible that a municipality is using more property than it would ultimately need to perform current and future original and optional, voluntary tasks.
- ¹⁰ Social and communal property as categories are unique to the former Yugoslavia. Social property can be defined as collectively owned (as in the case of agricultural collectives elsewhere) by workers or by residents of a municipality. Communal property is synonymous with municipal property elsewhere.
- ¹¹ Self-contribution: another unique feature of the former Yugoslavia that has survived to this date. Residents of a municipality or sub-municipality (community) vote to assess a tax or another type of one time or recurring donation to build infrastructure such as housing for the local doctor, additions to schools, new health clinics, roads, playgrounds etc. These types of assets, built entirely with local funds and with volunteer labor, were seized by the Milosević regime in 1995 and declared to be state assets in "use" by the municipalities. These should obviously be returned or compensation paid.
- ¹² If urban land was 'voluntarily' contributed by a municipality for the construction of a state enterprise or facility, and fair compensation was never paid at the time, then some procedure needs to be in place to avoid future lawsuits and administrative protests.
- ¹³ An exception was Latvia, where individuals could receive property in specie on an as is basis. According to Talis Linkaits' description, municipalities had to return real estate to individuals and religious organizations. Real estate had to be returned to their previous owners if

they submitted applications by December 3, 1994.

Restitution of enterprises could occur in three ways:

- 1) Property could be returned in kind.
- 2) Property rights could be restored by transferring shares of the enterprise in equal proportion to the amount of nationalized property.
- 3) The previous owners could receive compensation vouchers if they wish (compensation vouchers can be used to obtain state-owned land, enterprises or apartments).

The restitution principle was status quo. Previous owners were not compensated for property damage or

use, nor were current owners compensated for their investments. Only in the case of enterprises—if there was significant state or municipal investment, then in some cases the state or municipality could receive shares of the enterprise. The restitution was understood as a part of the economic reforms to encourage private initiative. There were deadlines to submit claims for property restitution. If a claim was not submitted before the deadline, the individual had to justify the lateness of their claims in court. Otherwise, no claims were accepted after the deadline.

¹⁴ From the brochure on asset management at www.urban-institute.hr.



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Local Government and Public Service Reform Initiative

The Local Government and Public Service Reform Initiative (LGI), a network program of the Open Society Institute (OSI), is an international development and grant-giving organization dedicated to the support of good governance in the countries of Central and Eastern Europe (CEE) and the Commonwealth of Independent States (CIS). LGI seeks to fulfill its mission through the initiation of research and support of development and operational activities in the fields of decentralization, public policy formation and the reform of public administration.

With projects running in countries covering the region from the Czech Republic to Mongolia, LGI seeks to achieve its objectives through:

- Development of sustainable regional networks of institutions and professionals engaged in policy analysis, reform-oriented training and advocacy
- Support and dissemination of in-depth comparative and regionally applicable policy studies tackling local government issues
- Support of country-specific projects and delivery of technical assistance to implementation agencies
- Assistance to Soros foundations with the development of local government, public administration and/or public policy programs in their countries
- Publication of books, studies and discussion papers dealing with issues of decentralization, public administration, good governance, public policy and lessons learned from the process of transition in these areas
- Development of curricula and organization of training programs dealing with specific local government issues
- Support of policy centers and think tanks in the region

Apart from its own projects, LGI works closely with a number of other international organizations (Council of Europe, The British Department for International Development, USAID, UNDP and World Bank) and co-funds larger regional initiatives aimed at the support of reforms on the subnational level. The Local Government Information Network (LOGIN) and the Fiscal Decentralization Initiative (FDI) are two main examples of this cooperation.

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